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No.

IN THE
Supreme Court of the United States

OCTOBER TERM, 1993

IN RE: TIME WARNER INC.
SECURITIES LITIGATION

STEVEN J. ROSS, N.J. NICHOLAS, JR., GERALD M. LEVIN, BERT W. WASSERMAN, and TIME WARNER INC.,

Petitioners,

v.

ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PENSION PLAN AND TRUST and BARRY ZONON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

QUESTIONS PRESENTED

A. Whether a plaintiff in a Rule 10b-5 securities fraud action can satisfy the requirement of pleading fraudulent intent by alleging that defendants acted in an economically irrational manner inconsistent with the efficient market doctrine adopted in *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988), but criticized by the court below?

B. Whether a securities fraud plaintiff can plead reliance based on *Basic*'s efficient market theory whereas a defendant can simultaneously be precluded from relying on that same theory to pierce plaintiff's implausible theory of fraudulent intent in a motion under Rules 12(b)(6) and 9(b)?

C. Whether the court below seriously eroded *Basic*'s efficient market theory, upon which the securities regulatory framework is based, thereby creating uncertainty and confusion in the rules governing the disclosure obligations of public companies and trading activities of investors?

PARTIES TO THE PROCEEDING

Petitioners, defendants in the district court and appellees in the court of appeals, are Time Warner Inc. and Steven J. Ross, N.J. Nicholas, Jr., Gerald M. Levin and Bert W. Wasserman.* Respondents, plaintiffs in the district court and appellants in the court of appeals, are ZVI Trading Corp. Employees' Money Purchase Pension Plan and Trust and Barry Zonon.

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* In accordance with Rule 29.1 of this Court, the currently-existing significant subsidiaries of Time Warner Inc., as listed in the Company's Report on Form 10-K for the year ended December 31, 1992, are included in the appendix hereto (App. 1a-13a).

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ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PENSION PLAN AND TRUST and BARRY ZONON,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Time Warner Inc. and the individual petitioners petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The divided opinion of the court of appeals, unreported, is set forth in the appendix hereto (App. 14a–42a). The district court's opinion, reported at 794 F. Supp. 1252, is set forth in the appendix (App. 46a–67a). The district court's opinion denying reconsideration, 1992 WL 178623, is set forth in the appendix (App. 43a–45a).

JURISDICTION

The judgment of the court of appeals was entered on November 30, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The statutory and regulatory provisions involved in this petition are set out in the appendix (App. 68a–72a).

STATEMENT

The Merger and Subsequent Events

Time Inc. and Warner Communications Inc. merged in January 1990 to form Time Warner Inc. ("TW"), the world's largest media and entertainment company. TW is active here and abroad in various fields, including publishing, music, motion pictures, television programming and cable television.

The original concept for the merger was an exchange of stock that involved no debt. In reaction to a hostile tender offer by Paramount, the merger was recast as a cash-stock transaction, which required TW to take on approximately $8 billion in debt.

Following the merger, management conceived plans to launch an expansion of TW's businesses, here and abroad, through strategic partnerships. TW sought such alliances principally to

compete more effectively on a worldwide basis and to enhance its technological capabilities.

In October 1991, TW announced an agreement to form a worldwide partnership at the subsidiary level with Toshiba Corporation and Itochu Corporation (formerly C. Itoh & Co., Ltd.). That alliance led to the creation of Time Warner Entertainment Company, L.P. ("TWE"), a limited partnership which holds TW's cable, filmed entertainment and programming businesses. Toshiba and Itochu paid $1 billion for minority limited partner interests in TWE. In 1993, TW announced yet another strategic alliance with U.S. West, which invested $2.5 billion in TWE. U.S. West and TW are working to develop TWE's cable operations into the interactive Full Service Network™ business.

After the TW merger, and prior to these alliances, the investment community took a bearish view of companies that were highly leveraged. Concern was expressed about the level of debt incurred by TW in connection with the merger.

On June 6, 1991, TW announced a rights offering to its stockholders to raise $2.1 to $3.5 billion of additional capital. The offer was designed to take advantage of a temporary window of opportunity—the market's receptivity to equity offerings. The rights offering was first suggested to TW by an outside investment banker in late April 1991 and became the subject of a month of intense debate by TW's management and its various financial advisors. On June 5, TW's Board authorized the rights offering. It was publicly announced the next day.

The offering, as originally conceived, involved a fixed "pool" of over 30 million shares of new common stock, with the per-share purchase price dependent on the number of rights exercised by stockholders, all of whom were awarded rights *pro rata*. The per-share price could have ranged from $63 (if 60% of the rights were exercised) to $105 (if 100% of the rights were exercised). This novel variable-price offering raised objections and, as a result, TW converted the proposal into a more conventional fixed-price underwritten offering of $80 per share. The offering, over-subscribed, was completed on August 5, 1991. TW raised $2.7 billion.

The Third Amended Complaint

Shortly after announcement of the rights offering, plaintiffs, purporting to represent a class of persons who purchased TW common stock between December 12, 1990 and June 7, 1991, filed a 10b-5 securities fraud complaint.

The complaint describes the background of Time's rejection of Paramount's $200-per-share contingent offer in 1989. According to the complaint, defendants, in the Fall of 1990, embarked on a campaign to convince the public that TW had an "intrinsic" value in excess of Paramount's $200-per-share price. The complaint asserts that defendants issued or stimulated statements about possible strategic alliances that were intended to "validate the pivotal decisions undertaken by the Time directors in rejecting the $200 per share Paramount offer."

The complaint alleges that on June 6, 1991, in a "dramatic shift contradicting the previous optimistic statements regarding the Company's prospects for a strategic alliance," TW announced a multi-billion dollars rights offering "in lieu" of an alliance. TW announced the rights offering, according to the complaint, because would-be partners refused to enter into transactions at price levels reflecting a $200-per-share intrinsic asset value and this refusal "would have destroyed [TW's management's] credibility" as to "their optimistic assessments of value." Defendants' alleged inability to conclude strategic alliances in a timely manner and their subsequent plans to raise capital by the "alternative" of a rights offering is claimed to have "rendered statements [about possible alliances] during the Class Period materially false and misleading."

The District Court's Opinion

The district court (Lasker, J.), dismissing the third amended complaint with prejudice under Rules 9(b) and 12(b)(6), held that plaintiffs failed to adequately allege (1) that defendants had made misleading statements or material omissions or (2) acted with fraudulent intent or scienter.

The district court held that the statements about possible alliances were not misleading and that there was no duty to disclose preliminary consideration of the rights offering. The district court ruled that plaintiffs' shifting theories of scienter were implausible and irrational. 794 F. Supp. at 260. The notion that defendants hyped the prospect of potential alliances to inflate TW's price in order to vindicate rejection of Paramount's offer made no sense, according to the court, because TW had no "unilateral ability" to force a prospective partner to invest in an alliance and, under plaintiffs' own scenario, TW would inevitably be compelled to undertake a securities offering that would depress the stock. *Id.*

The Decision of the Court of Appeals

The appellate court agreed that defendants' statements about alliance negotiations were not misleading. "Most of the statements reflect merely that talks are ongoing, and that Time Warner hopes that the talks will be successful" (App. 25a). But the Second Circuit disagreed with the district court on the questions of non-disclosure and scienter.

The Second Circuit held that TW *may* at some point have come under a duty to disclose its preliminary consideration of a rights offering in May 1991—even though any delay in disclosure would have been brief[1/] and even though a rights offering was not inconsistent with a strategic alliance.[2/] The Second Circuit panel, however, was sharply divided on the scienter issue. The majority (Judges Newman and Miner), repeatedly acknowledging that scienter was a "close question" even at the pleading stage

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1/ The majority acknowledged that the rights offering was announced shortly after its first consideration (App. 34a).

2/ The Second Circuit stated: "Time Warner potentially could have raised all its needed capital from either strategic alliances or a rights offering, or it could have raised part of the necessary capital using each approach" (App. 28a).

(App. 31a), accepted a theory first suggested in plaintiffs' appeal brief. That theory speculates that TW might have briefly delayed disclosure of its preliminary contemplation of the rights offering in the hope that it could then seek a higher price per share when that transaction was actually proposed.

Judge Winter, in a vigorous dissent, rejected this theory as irrational and contrary to *Basic Inc.* v. *Levinson*, 485 U.S. 224, 246-47 (1988), pointing out that under the efficient market theory adopted in *Basic*, the price of TW's stock would inevitably have declined when the rights offering was announced. He noted that there was a mandatory waiting period of at least ten days for the market to absorb the news.[3] Thus, there was no motive for briefly delaying the rights offering announcement. Judge Winter declared that plaintiffs' scienter theory "defies common sense," is "at odds with many long-standing assumptions of the securities laws," and is "contradicted by the complaints" which recognize that TW trades on an efficient market which promptly reflects publicly available information (App. 36a, 39a).[4]

The majority, however, was critical of this Court's efficient market theory in *Basic*—"confidence in the efficient markets hypothesis is not universally shared" (App. 32a); "the laws of economics have not yet achieved the status of the law of gravity" (App. 33a). The majority hypothesized that "however efficiently markets may be thought to work when disclosures are proper, it is not beyond doubt that they may not *fully* correct for prior misleading information once a necessary disclosure has been made" (App. 33a; emphasis in original); "it is *possible*, in some circumstances, that [delayed disclosure] *might* leave its effects lingering in

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[3] In fact, there was a 60-day period between the announcement and completion of the rights offering.

[4] The complaint alleges that TW's stock traded on an "efficient market and the trading price of its stock adjusted to reflect publicly available information" (¶ 8); and that the "stock reacted promptly to disclosure of material information" (¶ 90). (App. 73a).

the market for some time" (App. Id.; emphasis added). There was no explanation for this speculation as to possible lapses in an efficient market for a high-profile company in the context of a rights offering with a minimum ten-day waiting period before the effective date.

REASONS FOR GRANTING THE PETITION

The decision below—which is in conflict with opinions of this Court and other circuits—merits plenary review because it laid down erroneous principles of law that will stimulate a flood of Rule 10b-5 strike suits on far-fetched theories.

There are three compelling reasons for granting the petition:

First, the court below erodes the high standard of scienter required in Rule 10b-5 suits by this Court and other circuits by ignoring *Basic*'s efficient market theory. The court accepted irrational allegations of scienter—namely, that sophisticated executives displayed fraudulent intent by embarking on a scheme that assumed that TW's market price would not reflect an important corporate announcement. By precluding the dismissal of such far-fetched theories at the pleading stage, the Second Circuit's opinion will encourage a flood of 10b-5 strike suits, contrary to the policy enunciated in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975).

Second, the decision below adopts a discriminatory standard—it allows plaintiffs to rely on the efficient market theory in pleading fraud-on-the-market as a substitute for individual reliance, while at the same time depriving defendants of the right to rely on that same theory to pierce the complaint's implausible allegations of scienter. It is fundamentally unfair to allow plaintiffs to avoid pleading individual reliance—using the efficient market theory as a sword—while precluding defendants from invoking the same theory as a shield on a motion to dismiss. This, again, places the Second Circuit in conflict with other circuits.

Third, the efficient market theory is the linchpin of the SEC's regulatory regime. Market participants routinely take actions

on the premise—encouraged by the SEC—that disclosure permits them to proceed with various market transactions. But the decision below injects a new and unsettling element of uncertainty where before the law was clear: Now, market participants must ask themselves whether their public disclosures have been "sufficiently" impounded into the market price of securities—without any guidance from the courts as to how to make such an amorphous determination—upon pain of strike suits by disgruntled investors.

I.

THE DECISION BELOW ERODES THE WELL-ESTABLISHED STANDARD FOR PLEADING SCIENTER IN 10b-5 ACTIONS AND WILL STIMULATE A FLOOD OF VEXATIOUS SUITS

Ernst & Ernst v. *Hochfelder*, 425 U.S. 185 (1976), establishes a high standard of scienter—a 10b-5 plaintiff must prove that a defendant acted with intent to deceive, manipulate or defraud. There must be a "strong inference" of fraudulent intent.[2]

Intent, whether in the context of securities fraud, antitrust or RICO cases, cannot be established by alleging behavior that makes no economic sense. *See, e.g., Matsushita Electrical Industrial Co.* v. *Zenith Radio Corp.*, 475 U.S. 574 (1986) (rejection of antitrust conspiracy theory that assumed sophisticated businessmen embarked on scheme that did not "make economic sense"); *DiLeo* v. *Ernst & Young*, 901 F.2d 624 (7th Cir.) (Easterbrook, J.), *cert. denied*, 498 U.S. 941 (1990) (dismissal of a 10b-5 complaint that posited an irrational scienter theory); *Mid-State Fertilizer Co.* v. *Exchange Nat'l Bank*, 877 F.2d 1333,

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[2] *See, e.g., In re Glenfeld, Inc.* Securities Litigation, 1993 U.S. App. LEXIS 33327 (9th Cir. Nov. 15, 1993); *Renovitch* v. *Kaufman*, 905 F.2d 1040, 1046 (7th Cir. 1990); *Romani* v. *Shearson Lehman Hutton*, 929 F.2d 875, 878-80 (1st Cir. 1991).

1339 (7th Cir. 1989) (dismissal of a RICO claim accusing defendant of "irrational conduct").

But the decision below accepts a scienter theory that, as Judge Winter demonstrates, "defies common sense." The decision assumes that TW briefly delayed disclosing its preliminary consideration of a rights offering in the hope it could seek a higher price on the offering, even though the market would have at least ten days (and, here, forty days) to absorb the news before the offering became effective (and sixty days before the offering closed). The majority—disparaging *Basic* ("confidence in the efficient markets hypothesis is not universally shared")—conjectures that "however efficiently markets may be thought to work when disclosures are proper, it is not beyond doubt that they may not *fully* correct for prior misleading information once a necessary disclosure has been made" (App. 33a; emphasis in original); and that "it is *possible*, in some circumstances, that [delayed disclosure] *might* leave its effects lingering in the market for some time" (App. Id.; emphasis added).

The majority gives no explanation for its speculation about possible lapses in the efficiency of the market to impound public announcements by high-profile companies such as TW, particularly where there is a generous waiting period.

Judge Winter, in a strong dissent, criticizes the majority for not following *Basic*'s teaching that efficient markets impound significant public announcements. *Basic* declares that "empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all publicly available information;" and that "most publicly available information is reflected in market price." 485 U.S. at 246, 247.

Judge Winter declares: "The notion that the existing stockholders would continue to rely upon [previous] statements regarding fresh capital in the face of the coercive rights offering is entirely far-fetched" (App. 39a). This scienter scenario, according to Judge Winter, "posits a management that expects that the disclosure of the failure of the strategic alliance conversations and resort to a coercive rights offering would not be fully assimilated by shareholders during the [statutory] waiting period. It also posits

that a substantial number of shareholders would continue to give credence to statements that were weeks old and flatly contradicted by the registration statement" (App. 40a).

Judge Winter declares that there is no basis for the majority's unexplained speculation that the market will impound newly disclosed information if there was no prior non-disclosure but *might* not *fully* do so if there was prior non-disclosure. "It [the majority opinion] appears to posit that if A, Inc. truthfully projects high earnings and later states, again truthfully, that it now expects only to break even, the market can absorb the downgrading. It also seems to posit that if A, Inc. falsely projects high earnings but later states truthfully that it now expects only to break even, the market cannot fully absorb the downgrading. This does not seem plausible to me" (App. 42a). Judge Winter adds: "Nor can I find an explanation of why the inefficiency of the market is only on the up rather than the down side" (App. Id.).

Finally, Judge Winter points out that the last-minute scienter scenario is flatly contrary to plaintiffs' own allegations that TW's stock trades on an efficient market that promptly incorporates public information (App. 40a–41a).

The dissent is correct on all these points. The majority's erosion of *Basic*'s efficient market theory creates a conflict with every other circuit that has dealt with this issue. We count at least

seven circuits in conflict.[6] Those circuits have faithfully followed *Basic* and applied its theory of efficient markets.

The opinion below, by departing from *Basic*, eviscerates the requirement that the plaintiff plead a theory of fraudulent intent that is rational. The ruling will stimulate a flood of strike suits, on far-fetched scienter theories, contrary to the policies of *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 739 (1975) and Rule 9(b).[7]

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[6] *See, e.g., Peil* v. *Speiser*, 806 F.2d 1154 (3d Cir. 1986); *Shores* v. *Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983); *Wielgos* v. *Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989) (Easterbrook, J.); *Blackie* v. *Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *T.J. Raney & Sons* v. *Fort Cobb Okla. Irrig. Fuel Auth.*, 717 F.2d 1330 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Lipton* v. *Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132 (1985). *See also Eckstein* v. *Balcor Film Investors*, 1993 U.S. App. LEXIS 21634 at *25-26 (7th Cir. Aug. 20, 1993); *Roots Partnership* v. *Lands' End, Inc.*, 965 F.2d 1411, 1419 (7th Cir. 1992); *Freeman* v. *Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1114 (9th Cir. 1989), *cert. denied sub nom. Schneider* v. *Apple Computer, Inc.*, 496 U.S. 943 (1990).

[7] That Rule raises pleading standards in 10b-5 cases to prevent strike suits. *See, e.g., In re Glenfed, Inc. Securities Litigation*, 1993 U.S. App. LEXIS 33327 (9th Cer. Nov. 15, 1993); *Romani* v. *Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991).

II.

THE DECISION BELOW AUTHORIZES AN APPLICATION OF THE EFFICIENT MARKET THEORY WHICH UNFAIRLY DISCRIMINATES IN FAVOR OF PLAINTIFFS AND AGAINST DEFENDANTS IN 10b-5 ACTIONS

The decision below casts serious doubt on the viability of the fraud-on-the-market doctrine, upon which plaintiffs base their claim of reliance (Compl. ¶ 28(e)) (App. 41a; 73a), because that doctrine rests on the theory of efficient markets.

Traditionally, courts require Rule 10b-5 plaintiffs to prove that they relied on alleged misrepresentations. *Basic*, 485 U.S. at 243. The fraud-on-the-market doctrine, however, allows class action plaintiffs to plead, in lieu of individual reliance on alleged misrepresentations, that they relied on the market price which presumably impounds all publicly available information. But for that theory, class actions could rarely be maintained because each plaintiff would have to prove his or her own individual reliance; individual issues would thus overwhelm common ones, thereby eliminating the efficacy of class actions. *Basic*, 485 U.S. at 242.

As Judge Winter points out, plaintiffs' scienter scenario is inconsistent with their allegations that TW's stock trades on an efficient market that incorporates all available public information.[9] Thus, the court below allows plaintiffs to rely on the efficient market theory and its corollary, the fraud-on-the-market doctrine, as a proxy for reliance, but at the same time precludes defendants from invoking the efficient market theory on a motion under Rule 12(b)(6) to attack an irrational theory of fraudulent intent. If plaintiffs can plead the efficient market theory as a sword, defendants should be allowed to use it as a shield to dismiss a frivolous complaint.

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[9] *See* n.4 *supra*.

The decision below creates a direct conflict with other circuits that reject such one-sided use of *Basic*'s efficient market doctrine. *See Raab* v. *General Physics Corporation*, 4 F.3d 286, 289 (4th Cir. 1993) (dismissal of complaint where press release corrected previous misrepresentations; "the presumption that the market price has internalized all publicly available information cuts both ways"); *Roots Partnership* v. *Lands' End, Inc.*, 965 F.2d 1411, 1419 (7th Cir. 1992) (granting motion to dismiss fraud-on-the-market claim; courts will not "[p]resume that the market reacted to the allegedly fraudulent prediction but ignored later information of Lands' End's actual earning results").[2]

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[2] The decision below also undermines the "truth in the market" defense applied by other circuits. It is well settled that a defendant can rebut the presumption of reliance by showing "that information sufficient to correct the alleged misstatements was transmitted through the market price in the same fashion as the misstatements themselves." *In re Apple Computer Securities Litigation*, 886 F.2d 1109, 1115 (9th Cir. 1989), *cert. denied sub nom. Schneider* v. *Apple Computer, Inc.*, 496 U.S. 943 (1990). *See also Cooke* v. *Manufactured Homes*, 998 F.2d 1256 (4th Cir. 1993); *Roots Partnership* v. *Lands' End, Inc.*, 956 F.2d 1411, 1420 (7th Cir. 1992).

III.

THE DECISION BELOW IS INCONSISTENT WITH THE THEORY, UPON WHICH THE NATION'S SECURITIES REGULATORY REGIME IS BASED AND UPON WHICH MARKET PARTICIPANTS TRADITIONALLY RELY, THAT EFFICIENT MARKETS IMPOUND PUBLICLY AVAILABLE INFORMATION

Congress, in enacting the Securities Exchange Act of 1934, relied on the "premise that the market price of shares traded on well-developed markets reflects all publicly available information." *Basic*, 484 U.S. at 246. As Judge Winter observes, "the notion that markets impound available information relatively promptly in share prices, at least in widely traded share prices, pervades securities law . . . . One purpose of the [statutory] waiting period is to allow ample time for the information contained in the statement to be absorbed by investors" (App. 40a).

By leaving the door open to suits based on the theory that, despite truthful disclosures, defendants thereafter attempted to take advantage of some sort of hypothetical inefficient market "bubble," the Second Circuit's opinion risks deterring conduct that the SEC has repeatedly endorsed. In 1982, for example, the SEC adopted an integrated disclosure system authorizing abbreviated Forms S-3 and F-3 for widely followed companies like TW to update material changes by incorporating by reference disclosures in prior filings. *See* Adoption of Integrated Disclosure System, Securities Act Release No. 33-6383, 47 Fed. Reg. 11,380 (1982). In proposing the system, the SEC stressed its "belief that the market operates efficiently for [S-3] companies, *i.e.*, that the disclosure in Exchange Act reports and other communications by the registrant, such as press releases, has already been disseminated and accounted for by the marketplace." Reproposal of Comprehensive Revision to System for Registration of Securities Offerings, Securities Act Release No. 33-6331, 46 Fed. Reg. 41,902 (1981) (App. 71a).

SEC Rule 415, the shelf registration rule, is also based on the efficient market premise. 17 C.F.R. § 230.415(a)(1)(x)(1993). It allows issuers to file a Form S-3 or F-3 statement well in advance of the distribution of securities. The SEC declared: "Forms S-3 and F-3 recognize the applicability of the efficient market theory to those companies which provide a steady stream of high-quality corporate information to the marketplace and whose corporate information is broadly disseminated." Shelf Registration, Securities Act Release No. 33-6499, 48 Fed. Reg. 52,889 (1983) (App. 70a); *see also* 46 Fed. Reg. 41,902 (1981) (App. 71a).

The efficient market theory also underlies SEC Rule 175, one of the so-called safe harbor rules. *See* 17 C.F.R. 230.175 (1993) (App. 69a). "Like Forms S-3 and the shelf registration rules, Rule 175 assumes that readers are sophisticated, can understand the limits of a projection—and that if any given reader does not appreciate its limits, the reactions of the many professional investors and analysts will lead to prices that reflect the limits of the information." *Wielgos* v. *Commonwealth Edison Co.*, 892 F.2d 509, 514 (7th Cir. 1989) (Easterbrook, J.)

If the Second Circuit's decision is permitted to stand, those who have relied on these SEC rules in structuring and timing significant capital market transactions will be vulnerable to suit on the theory that, although the rules were compiled with and disclosures made, the defendants nevertheless committed fraud by pursuing the transaction before the information was fully impounded in the price of the security issue.

Finally, if the decision below stands, corporate insiders would never know when it is lawful to trade on publicly disclosed information. As the American Stock Exchange Company Guide states: "While the waiting period is dependent on the circumstances, the Exchange recommends that, as a basic policy . . . insiders should wait for at least 24 hours after the general publication of the release in a national medium. Where publication is not so widespread, a minimum waiting period of 48 hours is recommended." American Stock Exch. Company Guide § 402(f) at pp. 4-10 (Supp. 1988) (App. 72a). Traders cannot be sure that disclosure immunizes them from suits if plaintiffs can

maintain actions on the fanciful theory that the disclosure somehow had a delayed impact on market price, even in the case of widely-followed securities and well publicized disclosures.

The efficient market theory, in short, is a bedrock of the SEC's regulatory regime as well as judicial decisions. "Of all recent developments in financial economics, the efficient capital market hypothesis . . . has achieved the widest acceptance by the legal culture." R.J. Gilson & R.H. Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 549-50 (1984).

The decision below runs counter to settled legal principles. It conflicts with precedents of this Court, other circuits and the SEC. If left standing, the decision will stimulate a flood of strike suits, undermine the securities regulatory scheme, and create uncertainty and confusion for public companies and investors.

Conclusion

For all the reasons demonstrated above, the Court should grant the petition for a writ of certiorari.

Dated: January 24, 1994

Respectfully submitted,

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APPENDIX

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Statement Pursuant to Rule 29.1

Pursuant to Rule 29.1, Petitioner Time Warner Inc. reprints here its listing of substantial, currently-existing subsidiaries as annexed to its Report on Form 10-K for the year ended December 31, 1992.

SUBSIDIARIES OF TIME WARNER INC.

Set forth below are the names of certain subsidiaries, at least 50% owned, directly or indirectly, of the Company included in the consolidated financial statements of the Company and its subsidiaries in the Company's Annual Report on form 10-K for the year ended December 31, 1992, except for those subsidiaries marked by an asterisk (*) which are reflected in the consolidated financial statements on the equity basis. Certain subsidiaries which when considered in the aggregate would not constitute a significant subsidiary, are omitted from the list below. Indented subsidiaries are direct subsidiaries of the company under which they are indented.

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
TIME WARNER INC. (Registrant):		Delaware
Asiaweek Limited	79	Hong Kong
Sunset Publishing Corp.	100	Delaware
Time Inc.(1)	100	Delaware
American Family Publishers (partnership)	50	New York
Book-of-the-Month Club, Inc. .	100	New York
Entertainment Weekly, Inc. . . .	100	Delaware
Health Publications, Inc.	100	Delaware
*Hippocrates Partners (partnership)	50	California
Little, Brown & Company (Inc.)	100	Massachusetts

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Southern Progress Corporation(2)	100	Delaware
TDS Ventures, Inc.	100	Delaware
Time Distribution Services (partnership)	63	New York
Time Customer Service, Inc.	100	Delaware
Time Publishing Ventures, Inc.	100	Delaware
TWC Ventures Inc.	100	Delaware
*Whittle Communications, L.P. (partnership)	37	Delaware
Time International Inc.	100	Delaware
Time-Life International B.V.	100	Netherlands
Time Life Inc.	100	Delaware
Time-Life Customer Service, Inc.	100	Delaware
Time Life Home Video Inc.	100	Delaware
Warner Books, Inc.	100	New York
Warner Publisher Services Inc.	100	New York
TWE Holdings Inc.	100	Delaware
Time TBS Holdings, Inc.	100	Delaware
Warner Communications Inc.	100	Delaware
Warner Bros. Inc.	100	Delaware
DC Comics (partnership)	50	New York
Warner Bros. Publications Inc.	100	New York
Warner Bros. Music International Inc.(3)	100	Delaware
Warner-Tamerlane Publishing Corp.	100	California
WB Music Corp.	100	California
W Cinemas Holding Inc.	100	Delaware
W. Cinemas Inc.	100	Delaware
Alpha Theatres Inc.	100	Delaware
NPP Music Corp.	100	New York
Warner Air Inc.	100	Delaware
Warner/Chappell Music Inc.	100	Delaware

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
New Chappell Inc.(5)	95	Delaware
Summy-Birchard, Inc.	100	Wyoming
Summy Music K.K.	100	Japan
Lorimar Motion Picture Management, Inc.	100	California
Lorimar—Telepictures Magazines, Inc.	100	Delaware
Lorimar Music Publishing, Inc.	100	California
Lorimar Music Bee Corp.	100	Delaware
Lorimar Music A Corp.	100	Delaware
E.C. Publications, Inc.	100	New York
Publisher's Advertising Associates, Inc.	100	New York
Warner Music Group Inc.	100	Delaware
Warner Bros. Records Inc.	100	Delaware
Atlantic Recording Corporation	100	Delaware
Super Hype Publishing, Inc.	100	New York
Cotillion Music, Inc.	100	Delaware
Walden Music, Inc.	100	New York
Warner-Elektra-Atlantic Corporation	100	New York
WEA International Inc.(4)	100	Delaware
Warner Music Japan Inc.	100	Japan
Warner Special Products Inc.	100	Delaware
WEA Manufacturing Inc.	100	Delaware
Allied Record Company	100	California
Time Warner Limited	100	U.K.
Warner Music International Services Ltd.	100	U.K.
Time Warner UK Limited	100	U.K.
Warner Chappell Music Group (UK) Limited	100	U.K.
Warner Chappell Music Limited	100	U.K.
Magnet Music Ltd.	100	U.K.
Warner Music (U.K.) Limited	100	U.K.

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Ivy Hill Corporation	100	Delaware
Warner Cable Operating Inc.	100	New York
Warner Cable Communications Company (partnership)	100(6)	New York
Warner Cable Communications Inc.(7)	100	Delaware
SIFTA Milwaukee Cable Corp.	100(8)	Delaware
TA Milwaukee Cable Co., Inc.	100(8)	Delaware
Warner Cable of New York, Inc.	100(8)	Delaware
TWI Ventures Ltd.	100	Delaware
American Television and Communications Corporation	(9)	Delaware
Capital Cablevision Systems, Inc.	87.21(10)	New York
Memphis CATV, Inc.	87.21(11)	Tennessee
People's Cable Corporation	87.21(10)	New York
American Communications Corporation	82.33	Indiana
American Cablevision of Monroeville, Inc.	100	Pennsylvania
American Digital Communications, Inc.	100	Delaware
American Television of California, Inc.	100	California
ATC Cablevision of San Merino, Inc.	80	California
ATC Cablevision of South Pasadena, Inc.	80	California
American Cablevision of Kansas City, Inc.	100	Missouri
Kansas City Cable Partners (partnership)	100	Colorado
ATC Holdings, Inc.	100	Delaware
ATC Holdings II, Inc.	100	Delaware
ARP 113, Inc.	100	Delaware

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Paragon Communications (partnership)	50(12)	Colorado
ATC Satellite Inc.	100	Delaware
ATC/PPV, Inc.	100	Delaware
Carolina Network Corporation	100	Delaware
Laurel Cablevision, Inc.	100	Connecticut
Philadelphia Community Antenna Television Company	100	Pennsylvania
Lower Bucks Cablevision, Inc.	100	Pennsylvania
Tri-County Cable Television Company	100	New Jersey
Public Cable Company	88.39	Maine
Public Cable Company (partnership)	77	Maine
Shows, Inc.	100	Pennsylvania
Home Box Office, Inc.	(13)	Delaware
HBO Film Management, Inc.	100	Delaware
Kremlin Productions, Inc.	100	Delaware
Simba Productions, Inc.	100	Delaware
WAC Productions, Inc.	100	Delaware
Running Mates, Inc.	100	Delaware
Time Warner Cable Inc.	(13)	Delaware

Subsidiaries of Time Warner Entertainment Company, L.P.

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Century Venture Corporation	50	Texas
Century Colorado Corp.	100	Delaware
Colorado Springs Cablevision, Inc.	100	Colorado
Colorado Springs Citizens Cable, Inc.	100	Delaware

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
CV of Viera Joint Venture (partnership)	50	Florida
Erie Telecommunications, Inc.	54.19	Pennsylvania
Inverness/ATC Joint Venture (partnership)	50	Colorado
Time Warner Cable New Zealand Ltd.	99(14)	New Zealand
Queens Inner Unity Cable System	49(15)	New York
Comedy Partners (partnership)	50	New York
Crimson Satellite Associates (partnership)	50	New York
HBO Olé (partnership)	50	New York
HBO Olé Distribution 1 A.V.V.	100	Aruba
HBO Olé International/Sales Company Ltd.	100	British Virgin Is.
HBO Olé Services S.A.	100	Venezuela
HBO Olé Producciones S.A.	50	Venezuela
HBO Satellite Services, Inc.	100	Delaware
HBO Turkey Holdings I Inc.	100	Delaware
HBO Turkey Holdings II Inc.	100	Delaware
Warner Cable of New Jersey Inc.	100	Delaware
Warner Cable of Vermont Inc.	100	Delaware
Warner Bros. (F.E.) Inc.	100	Delaware
Warner Bros. (Japan) Inc.	100	Delaware
Warner Bros. (South) Inc.	100	Delaware
Warner Bros. (Transatlantic) Inc.	100	Delaware
Warner Films Consolidated Inc.	100	Delaware
Exeter Distributing Inc.	100	Delaware
Riverside Distributing Inc.	100	Delaware

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Home Box Office (Singapore) Pty. Ltd.	100	Singapore
Turner/HBO Limited Purpose Venture Joint Venture (partnership)	50	New York
Acapulco 37 S.A. de C.V.	100	Mexico
Warner Bros. Beteiligungs Gesellschaft mbH	100	Austria
Time Warner Entertainment Limited	100	U.K.
Time Warner Entertainment (UK) Limited	100	U.K.
Bountiful Co. Ltd.	50	U.K.
Warner Bros. Consumer Products (UK) Ltd.	100	U.K.
TWE Finance Limited	100	U.K.
Warner Bros. Theatres Ltd.	100	U.K.
Warner Bros. Distributors Ltd.	100	U.K.
Lorimar Telepictures International Ltd.	100	U.K.
Lorimar International Italia S.r.L.	100	Italy
Terremodo Ltd.	100	U.K.
Victory Film Production, Ltd.	100	U.K.
Lorimar Music Limited	100	U.K.
Warner Bros. Theatres (U.K.) Limited	100	U.K.
Warner Bros. Investments (Pilsworth) Limited	100	U.K.
Warner Bros. Theatres Advertising Agency Limited	100	U.K.
Warner Bros. Theatres Equipment Supply Limited	100	U.K.

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Warner Bros. Productions Limited	100	U.K.
Hobby Films Ltd.	100	U.K.
Nabland Ltd.	100	U.K.
Rainbowcheer Ltd.	100	U.K.
Warner Home Video (U.K.) Limited	100	U.K.
Metro Color Laboratories (U.K.) Ltd.	100	U.K.
Kay Holdings Ltd.	100	U.K.
Metrocolor (London) Limited	100	U.K.
Geffen Film Company (partnership)	50	New York
Lorimar Distribution International (Canada) Corp.	100	Canada
Lorimar Canada, Inc.	100	Canada
Productions et Editions Cinematographiques Francaises SARL (PECF)	100	France
Warner Home Video France S.A.	100	France
Quinn Martin Warner Productions (partnership)	50	
Quinn Martin Warner FBI Stories (partnership)	50	
Time Warner Entertainment Australia Pty. Ltd.	100	Australia
Amicus Television Pty. Ltd.	100	Australia
Lorimar-Telepictures Pty. Limited	100	Australia
Sari Lodge Pty. Limited	50	Australia
Sea World Management Pty. Ltd.	50	Australia
Warner Bros. (Australia) Pty. Ltd. Limited	100	Australia

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Warner Holdings Australia Pty. Limited	100	Australia
Warner Bros. Properties (Australia) Pty. Ltd.	100	Australia
Warner Bros. Theatres (Australia) Pty. Limited	100	Australia
Warner World Australia Pty. Limited	100	Australia
Movie World Enterprises Partnership (partnership)	50	Australia
Warner Home Video Pty. Limited	100	Australia
Warner Bros. Video Pty. Ltd.	100	Australia
Warner Sea World Aviation Pty. Ltd.	100	Australia
Sea World Aviation Partnership (partnership)	50	Australia
Warner Sea World Investments Pty. Limited	100	Australia
Warner Sea World Operations Pty. Ltd.	100	Australia
Sea World Enterprises Partnership (partnership)	50	Australia
Warner Sea World Units Pty. Ltd.	100	Australia
Time Warner Entertainment GmbH	100	Germany
Warner Bros. Deutchland Pay TV GmbH	100	Germany
Warner Home Video GmbH	100	Germany
Warner Bros. Films GmbH	100	Germany
Warner Bros. Film GmbH Kinobertriebe	100	Germany
Constantin Warner Kina GmbH	50	Canada

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Time Warner Merchandising Canada Inc.	100	Canada
Warner Bros. Canada Inc.	100	Canada
Warner Bros. Distributing (Canada) Limited	100	Canada
Warner Home Video (Canada) Ltd.	100	Canada
Warner Bros. (Africa) (Pty) Ltd.	100	So. Africa
Warner Bros. Belgium SA/NV	100	Belgium
Warner Bros. (D) A/S	100	Denmark
Warner & Metronome Films A/S	50	Denmark
Warner Scala A/S	100	Denmark
Scala Biografome I/S (partnership)	50	Denmark
Warner Dagmar A/S	100	Denmark
Dagmar Teatret I/S (partnership)	50	Denmark
Warner Bros. Film Ve Video	100	Turkey
Warner Bros. Finland OY	100	Finland
Warner Bros. (Holland) B.V.	100	Holland
Warner Home Video (Nederland) B.V.	100	Netherlands
Warner Bros. Theatres (Holland) B.V.	100	Netherlands
Warner Bros. Holdings Sweden AB	100	Sweden
Warner Bros. (Sweden) AB	100	Sweden
Warner Home Video (Sweden) AB	100	Sweden
Warner Bros. Italia S.p.A.	100	Italy
Cinema Data Service S.r.L.	100	Italy
Warner Entertainment Italia SrL	100	Italy
Warner Bros. (Korea) Inc.	100	Korea
Warner Bros. (Mexico) S.A.	100	Mexico

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Warner Bros. (N.Z.) Limited	100	New Zealand
Warner Home Video (N.Z.) Limited	100	New Zealand
Warner Bros. Norway A/S	100	Norway
Warner Bros. Seven Distributing Co. (partnership)	100	
Warner Bros./S 1984-1985 Television Co. SYCA (partnership)	100	
Warner Bros. Singapore Pte. Ltd.	100	Singapore
Warner Home Video (Ireland) Ltd.	100	Ireland
Warner Home Video Portugal Lda.	100	Portugal
Warner Home Video Spol SRO . . .	100	Czechos.
Warner Home Video Espanola S.A.	100	Spain
Warner Bros. Licensing Espanola S.A.	100	Spain
Warner-Lusomundo Sociedade Iberica de Cinemas Lda.	50	Portugal
Warner Mycal Corporation	50	Japan
Kabelkom Management Co. (partnership)	50	Delaware
Kabelkom Holding Co. (partnership)	50	Delaware
Anfel-Kabelkom Kabelkommunikacios Kft	50	Hungary
Hajdu-Kabelkom Kabelkommunikacios Kft	81	Hungary
Kabelkom Kabeltelevizio Kft	100	Hungary
Kabeldatakom Szamitastechnikal Kft	51	Hungary
Kabelkom-Dunaujvaros Kabelkommunikacios Kft	70	Hungary

Name	Percentage Owned by Immediate Parent	State or other Jurisdiction of Incorporation or Organization
Kabelkom-Kelenfold Kabeltelevisio Kft	100	Hungary
Kabelkom-Nagykanizea Kabeltelevisio Kft	100	Hungary
Kabelkom-Nyiregykaza Kabelkommunikacios Kft	80	Hungary
Kabelkom-Szekesfehervor Kabelkommunikacios Kft	50	Hungary
Kabelkom-Veszprem Kabelkommunikacios Kft	57.8	Hungary
Pecal Kabeltelevizio Kft	70.4	Hungary
Telestar-Kabelkom Kabelkommunikacios Kft	50	Hungary
Quincy Jones Entertainment Company L.P. (partnership)	50	Delaware
Six Flags Entertainment Corporation	50	Delaware
SF Holdings Inc.	100	Delaware
Six Flags Theme Parks Inc. . .	71.5	Delaware
DC Comics (partnership)	50	New York

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(1) The names of 5 subsidiaries of Time Inc. carrying on the magazine publishing business are omitted.

(2) The names of 8 subsidiaries of Southern Progress Corporation carrying on the magazine or book publishing businesses are omitted.

(3) The names of 10 subsidiaries of Warner Bros. Music International carrying on substantially the same music publishing operations in foreign countries are omitted.

(4) The names of 63 subsidiaries of WEA International Inc. carrying on substantially the same record, tape and video cassette distribution operations in foreign countries are omitted.

(5) The names of 46 subsidiaries of New Chappell Inc. carrying on substantially the same music publishing operations in foreign countries are omitted.

(6) Warner Communications Inc. owns 100% of Warner Cable Communications Company indirectly through Warner Cable Operating Inc. and Publisher's Advertising Associates, Inc.

(7) The names of 10 other subsidiaries of Warner Cable Communications Inc. carrying on the cable television business are omitted.

(8) 92.92% owned by Warner Cable Communications Inc., 7.08% owned by Warner Communications Inc.

(9) 87.21% owned by TWE Holdings Inc., 7.07% owned by Warner. Communications Inc. and 5.71% owned by Time TBS Holdings, Inc.

(10) 87.21% owned by American Television and Communications Corporation, 7.07% owned by Warner Communications Inc. and 5.71% owned by Time TBS Holdings, Inc.

(11) 87.21 owned by American Television and Communications Corporation, 11.53% owned by Warner Communications Inc. and 1.26% owned by Time TBS Holdings, Inc.

(12) American Television and Communications Corporation owns 50% of Paragon Communications through two indirectly owned subsidiaries—31.09% through ATC Holdings II, Inc. and 18.91% through ARP 113, Inc.

(13) 87.21% owned by TWE Holdings Inc. and 12.79% owned by Warner Communications Inc.

(14) Remaining 1% owned by Time Warner Inc.

(15) Additional 1% owned by Warner Cable of New York, Inc.

United States Court of Appeals
FOR THE SECOND CIRCUIT

No. 836—August Term 1992

Argued: January 29, 1993 **Decided:**

Docket No. 92-7816

IN RE: TIME WARNER INC. SECURITIES LITIGATION.

ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PENSION PLAN AND TRUST, and BARRY ZONON,

Plaintiffs-Appellants,

v.

STEVEN J. ROSS, N.J. NICHOLAS, JR., GERALD M. LEVIN, BERT W. WASSERMAN, and TIME WARNER INC.,

Defendants-Appellees.

Before: NEWMAN, *Chief Judge*,
WINTER and MINER, *Circuit Judges*.

Appeal from the June 1, 1992, order of the United States District Court for the Southern District of New York (Morris E. Lasker, Judge) dismissing plaintiffs' complaint, 794 F. Supp. 1252, and the July 16, 1992, order denying plaintiffs' motion for reconsideration.

Order of dismissal reversed and case remanded. Judge Winter dissents with a separate opinion.

Arthur R. Miller, Cambridge, Mass. (David J. Bershad, Sol Schreiber, Lee S. Shalov, James E. Tullman, Milberg Weiss Bershad, Specthrie & Lerach, New york, N.Y.; Michael J. Freed, Joseph D. Ament, Ellyn M. Lansing, Much Shelist Freed Denenberg & Ament, Chicago, Ill. Roger W. Kirby, Kaufman Malchman Kaufmann & Kirby, New York, N.Y. on the brief), for plaintiffs-appellants.

Stuart Robinowitz, New York, N.Y. (Jonathan J. Freedman, Matthew L. Levine, Paul, Weiss, Rifkind, Wharton & Garrison, New York, N.Y. on the brief), for defendants-appellees.

JON O. NEWMAN, *Chief Judge*:

This appeal from the dismissal of a securities fraud complaint requires us to consider the recurring issue of whether stock fraud claims are sufficiently pleaded to warrant at least discovery and perhaps trial. Three separate issues are presented (1) whether a corporation has a duty to update somewhat optimistic predictions about achieving a business plan when it appears that the plan might not be realized, (2) whether a corporation has a duty to disclose a specific alternative to an announced business plan when that alternative is under active consideration, and (3) whether a corporation is responsible for statement in newspapers and security analyst reports that are attributed to unnamed corporate personnel. These issues arise on an appeal by plaintiffs ZVI Trading Corporation Employees' Money Purchase Pension Plan and Trust and Barry Zolon from the June 1, 1992, order of the District Court for the Southern District of New York (Morris E. lasker, Judge) dismissing plaintiffs' complaint, 794 F. Supp. 1252 (S.D.N.Y. 1992), and the July 16, 1992, order denying plaintiffs' motion for reconsideration.

Plaintiffs' complaint alleged that defendant Time Warner, Inc. and four of its officers had misled the investing public by statements and omissions made in the course of Time Warner's efforts

to reduce its debt. The District Court dismissed the complaint with prejudice for failure to adequately plead material misrepresentations or omissions attributable to the defendants and for failure to adequately plead scienter. We hold that the complaint's allegations of scienter and certain of its allegations concerning omissions are adequate to survive a motion to dismiss, and we accordingly reverse the order of dismissal and remand.

Background

One June 7, 1989, Time, Inc. received a surprise tender offer for its stock from Paramount Communications. Paramount's initial offer was $175 per share, in cash, and was eventually increased to $200 per share. *See Paramount Communications, Inc.* v. *Time Inc.*, 571 A.2d. 1140, 1147-49 (Del. 1989). Time's directors declined to submit this offer to the shareholders and continued discussions that had begun somewhat earlier concerning a merger with Warner Communications, Inc. Eventually, Time and Warner agreed that Time would acquire all of Warner's outstanding stock for $70 per share, even though this acquisition would cause Time to incur debt of over $10 billion. Time shareholders and Paramount were unsuccessful in their effort to enjoin the Warner acquisition, which was completed in July 1989.

Thus, in 1989, Time Warner Inc., the entity resulting from the merger, found itself saddled with over $10 billion in debt, an outcome that drew criticism from many shareholders. The company embarked on a highly publicized campaign to find international "strategic partners" who would infuse billions of dollars of capital into the company and who would help the company realize its dream of becoming a dominant worldwide entertainment conglomerate. Ultimately, Time Warner formed only two strategic partnerships, each on a much smaller scale than had been hoped for. Faced with a multi-billion dollar balloon payment on the debt, the company was forced to seek an alternative method of raising capital—a new stock offering that substantially diluted the rights of the existing shareholders. The company first proposed a variable price offering on June 6, 1991. This proposal was rejected by the SEC, but the SEC approved a second proposal announced on July 12, 1991. Announcement of the two offering proposals caused

a substantial decline in the price of Time Warner Stock. From June 5 to June 12, the share price fell from $117 to $94. By July 12, the price had fallen to $89.75.

The plaintiff class, which has not yet been certified, consists of persons who bought Time Warner stock between December 12, 1990, and June 7, 1991. Their complaint, containing causes of action under sections 10(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a) (1988), and state law, alleges that a series of statements from Time Warner officials during the class period were materially misleading in that they misrepresented the status of the ongoing strategic partnership discussions and failed to disclose consideration of the stock offering alternative. The parties have classified the challenged statements in two categories: (1) press releases and public statements from the individual defendants, (2) statements to reporters and security analysts emanating from sources within the company but not attributed to any identified individual. The statements, which we discuss in more detail below, consist of generally positive messages concerning the progress of the search for strategic partners, and imply to varying degrees that significant partnerships will be consummated and announced in the near future. None of the statements acknowledged that negotiations with prospective partners were going less well than expected or that an alternative method of raising capital was under consideration.

Plaintiff ZVI Trading filed its complaint on June 14, 1991, and amended the complaint on June 19 to add one additional defendant, to expand the class period, and to supplement the list of alleged misstatements. Plaintiff Barry Zolon filed a complaint on June 24, 1991. Plaintiffs made discovery requests in June and July, and defendants moved on August 21 for a protective order pending resolution of an anticipated motion to dismiss. Defendants' motion papers argued in part that the complaint was inadequate. The District Court granted the protective order motion in part, limiting plaintiffs' discovery to documents produced in an unrelated Delaware action that challenged the terms of the rights offering. Pursuant to a stipulated order, plaintiffs filed on August 30 a consolidated complaint that responded to some of the deficiencies defendants had complained of in their protective order motion. On October 11, defendants moved to dismiss under Rules 9(b) and

12(b)(6) of the Federal Rules of Civil Procedure. Relying on both rules, the District Court granted the motion and denied plaintiffs leave to amend the complaint.

The District Court's opinion considered the two categories of misstatements in turn. As to the first category—attributed public statements by the individual defendants or the corporation—the Court agreed that defendants attempted to drum up enthusiasm for strategic partnerships and did not disclose either their difficulties in pursuing that course or the possibility of a stock offering. But the Court found that the statements were accurate when made, and that later events did not give rise to a duty to correct or update the statements. The Court also concluded that plaintiffs had not adequately pled scienter under any theory. As to the second category of statements, the Court ruled that Rule 9(b) required plaintiffs to allege the identity of the speakers. The Court further concluded that the defendants could not be held responsible for any of the unattributed statements and that in any event the statements were not actionable for the same reasons that the attributed statements were not actionable. The Court then dismissed plaintiffs' pendent state claims of common law fraud and negligent misrepresentation on the merits. Finally, the Court concluded that leave to replead should not be granted, since the defects went to the merits and were not mere pleading niceties.[1/]

[1/] Judge Lasker's dismissal order was never embodied in a judgment, in apparent disregard of the separate document rule, Fed. R. Civ. P. 58. Nonetheless, we can treat the dismissal order as a final decision for purposes of 28 U.S.C. § 1291, since lack of compliance with the separate document rule is a waivable defect, and no party has complained. *See Bankers Trust Co.* v. *Mallis*, 435 U.S. 381, 384 (1978) (per curiam). Treating the June 1, 1992, order as final, we also find that the appeal was timely filed. Plaintiffs moved for reargument on June 15, 1992, within the ten-day period, as calculated under Fed. R. Civ. P. 6(a), allowed for a motion under Fed. R. Civ. P. 59(e). Notice of appeal was filed within 30 days of denial of this motion, bringing up for appeal the June 1, 1992, final decision. *See* Fed. R. App. P. 4(a)(4).

Discussion

Cases of this sort present an inevitable tension between two powerful interests. On the one hand, there is the interest in deterring fraud in the securities markets and remedying it when it occurs. That interest is served by recognizing that the victims of fraud often are unable to detail their allegations until they have had some opportunity to conduct discovery of those reasonably suspected of having perpetrated a fraud. Consistent with that interest, modern pleading rules usually permit a complaint to survive dismissal unless, in the familiar phrase, "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *See Conley* v. *Gibson*, 355 U.S. 41, 45-46 (1957).

On the other hand, there is the interest in deterring the use of the litigation process as a device for extracting undeserved settlements as the price of avoiding the extensive discovery costs that frequently ensue once a complaint survives dismissal, even though no recovery would occur if the suit were litigated to completion. It has never been clear how these competing interests are to be accommodated, and the adjudication process is not well suited to the formulation of a universal resolution of the tensions between them. In the absence of a more refined statutory standard than the vague contours of section 10(b) or a more detailed attempt at rule-making than the SEC has managed in Rule 10b-5, despite 50 years of unavailed opportunity, courts must adjudicate the precise cases before them, striking the balance as best they can.

In doing so, we do well to recognize several consequences of this common law approach to what is supposed to be a statutory standard. First, our outcomes will not necessarily evolve a discernible pattern. Second, the absence of a clear pattern will inevitably create uncertainty in the fields of both securities and litigation. Third, however sensitively we strike the balance in a particular case, we will not avoid the risks of adverse consequences: in the aftermath of any ruling that upholds the dismissal of a 10b-5 suit, there will be some opportunity for unremedied fraud; in the aftermath of any ruling that permits a 10b-5 suit to progress beyond a motion to dismiss, there will be some opportunity to extract an undeserved settlement. Unattractive as those prospects are, they

neither indicate a sound basis for decision nor permit avoidance of decision.

To state a cause of action under Rule 10b-5, a plaintiff must plead that "in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff's reliance on defendant's action caused [plaintiff] injury." *Bloor* v. *Carro, Spanbock, Londin, Rodman & Fass*, 754 F.2d 57, 61 (2d Cir. 1985). The shortcomings of the complaint identified by the District Court were the failure to identify a false material representation or material undisclosed information, and the failure to adequately plead scienter. We find it convenient to consider first the so-called unattributed statements before turning to those for which Time Warner acknowledges responsibility.

I. Existence of an actionable misrepresentation or omission

A. Anonymous statements to reporters and analysts

We first consider whether the District Court properly concluded that Rule 9(b) required dismissal of allegations of fraudulent statements when the complaint failed to identify the speaker. The complaint contains excerpts from a variety of newspaper stories and security analysts reports. Some of these accounts contain anonymous quotes or paraphrases of statements from alleged Time Warner insiders. Others merely report upon Time Warner's activities. In both cases, plaintiffs allege that some as yet unknown agents of Time Warner made misleading statements (or omitted to disclose material information) in discussions with the reporter or analyst. These reports and stories, excerpted in the complaint at §§ 42, 44-47, 49, 54, 58-62, 65, 69, 72, generally confirm that negotiations concerning strategic alliances are ongoing and add little to the statements for which Time Warner is concededly responsible. But some of the statements implied in the reports and stories would

bolster plaintiffs' case considerably. We have included the relevant excerpts in the margin.[2/]

[2/] 1. Time Warner has "indicated that it has had serious negotiations concerning the sale of an interest in some of its cable systems... and continues to explore joint ventures with Japanese, European, and U.S. companies which would help [Time Warner] reduce its debt." (Merrill Lynch, Oct. 23, 1990). Third Amended Complaint ¶ 44.

2. Time Warner "management is working on a fairly dramatic restructuring involving joint venture partners and substantial downpayment of debt. Such amove could eliminate the leverage worries for the stock and highlight values." (Smith Barney, Oct. 31, 1990). *Id.* ¶ 47.

3. Time Warner appeared to be moving closer to completing a strategic alliance. Ross and Nicholas had been "globetrotting since last year talking to potential partners." (Wall Street Journal, Feb. 13, 1991) (portion of quotation is paraphrased in complaint) *Id.* ¶ 58.

4. "[W]e assign a high probability to a restructuring within a year...." (Donaldson Lufkin & Jenrette buy recommendation, Feb. 13, 1991). *Id.* ¶ 69(i).

5. Time Warner has "said all along we are interested in the concept of international partnership, and we have been talking with many interested parties.... Now we are in the process of selecting from among them those that share our vision." (Time Warner spokesman, Feb. 15, 1991). *Id.* ¶ 59.

6. "We continue to expect an asset sale, joint venture or other major restructuring some time this year." (Wertheim Schroeder buy recommendation, Feb. 15, 1991). *Id.* ¶ 69(ii).

7. Time Warner expected to complete one or more transactions in 1991. (Paraphrase of alleged statement by Time Warner at security analysts meeting, Feb. 20, 1991), *Id.* ¶ 60.

8. "Working aggressively, [Time Warner] expects to complete a deal in 1991." (Wertheim Schroeder, Feb. 20, 1991). *Id.* ¶ 69(iii).

(continued...)

Rule 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or malice shall be stated with particularity." Judge Lasker understood Rule 9(b) to require, at a minimum, that the plaintiff identify the speaker of the allegedly fraudulent statements. We believe that he was correct. Plaintiffs rely on several district court decisions that they claim apply a less strict rule for statements attributed to corporate "spokespersons," *see In re AnnTaylor Stores Securities Litigation*, 807 F. Supp. 990, 1004 (S.D.N.Y. 1992); *Cytryn* v. *Cook*, Fed. Sec. L. Rep. (CCH) ¶ 95,409 (N.D. Cal. July 2, 1990), and for statements by newspapers and analysts allegedly caused by corporate employees, *see Alfus* v. *Pyramid Technology Corp.*, 764 F. Supp. 598, 603 (N.D. Cal. 1991); *In re Columbia Securities Litigation*, 747 F. Supp. 237, 245 (S.D.N.Y. 1990). These cases are distinguishable on their facts, in that they involve official press releases, *see AnnTaylor*, 807 F. Supp. at 1004–05; *see also Devittorio* v. *Equidyne Extractive Industries, Inc.*, 882 F.2d 1242, 1247 (2d Cir. 1987) (offering statement), statements by named individuals to analysts or reporters, *see Columbia*, 747 F. Supp. at 245; *Cytryn*, Fed. Sec. L. Rep. (CCH) at 97,016, or the defendant's placing its "imprimatur" on analyst's reports, *see Alfus*, 764 F. Supp. at 603; *see also Elkind* v. *Liggett & Myers, Inc.*, 635 F.2d 156, 163–64 (2d Cir. 1980). None of these cases sanctions the pleading of fraud through completely unattributed statements, even when the plaintiff

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[2/](...continued)

9. Time Warner executives said they were "in the process of selecting partners from among many prospects they have met." (Wall Street Journal, Feb. 21, 1991). *Id.* ¶ 61.

10. Talks had "intensified." (Time Warner spokesman, quoted in the "press," Apr. 19, 1991). *Id.* ¶ 65.

11. Talks had intensified and there should be a definitive announcement by year-end. (Wertheim Schroeder, Apr. 19, 1991). *Id.* ¶ 69(ix).

12. The "company has been saying and continues to say that discussions to form partnerships are ongoing." (Time Warner spokesman, June 5, 1991). *Id.* ¶ 72.

alleges on information and belief that the unattributed statement was made by an agent of the defendant.

Just as 10b-5 litigation, however resolved, risks adverse consequences, as we have noted, a strict application of Rule 9(b) in the context of unattributed statements also risks unfortunate effects. A scheming corporation could inflate its stock price through fraudulent statements whispered to reporters or analysts. If the reporters or analysts refused to reveal their sources and if no one inside the corporation leaked to the stockholders or to regulators the identity of the speakers, the corporation would have perpetuated a fraud that could not be remedied by a private civil action under the federal securities laws. For several reasons, however, we have some confidence that this is not a sufficiently likely scenario to justify a rule that would permit a suit alleging unattributed statements to survive a motion to dismiss.

As an initial matter, the function of financial reporters and security analysts is to determine the truth about the affairs of publicly traded companies. Few reporters or analysts would knowingly abet a fraud, and many will detect and reveal a corporation's efforts to use them as a channel for fraudulent statements. Additionally, investors tend to discount information in newspaper articles and analyst reports when the author is unable to cite specific, attributable information from the company. Thus, the opportunity to manipulate stock prices through the planting of false stories is somewhat limited. Finally, the effect of a less strict construction of Rule 9(b) would be only to allow discovery on the issue of the linkage between the corporation and the newspaper stories or analyst reports. Sometimes, of course, plaintiff's counsel would be able to use discovery to determine the identity of the speaker, and would find that this speaker was a person for whom the corporation was responsible. But far more often, we suspect, this would not be the case. Either the corporation is not responsible for the statements, in which case it has been unnecessarily burdened either by the expense of discovery or by a settlement extracted under threat of such discovery, or it is responsible, and having exhibited sufficient devotion to a fraudulent scheme so as to prevent attribution of statements in advance of discovery, it will often attempt and sometimes succeed in stonewalling discovery.

Alternatively, the District Court found that the unattributed statements, even if attributable to Time Warner, were not actionable. We do not reach this issue, since we find that dismissal with prejudice under Fed. R. Civ. P. 9(b) was proper as to these statements. It is true that dismissal under Rule 9(b) is usually without prejudice, *see Luce* v. *Edelstein*, 802 F.2d 49, 56-57 (2d Cir. 1986), but plaintiffs, though offered the opportunity by the District Court, have presented nothing to suggest that they could amend the complaint to adequately plead a link between the defendants and the unattributed statements.

B. Attributed statements and corporate press releases

We next focus on those statements as to which there is no issue of attribution. While plaintiffs claim that these statements were misleading, in that they exaggerated the likelihood that strategic alliances would be made, plaintiffs primarily fault these statements for what they did not disclose. The nondisclosure is of two types: failure to disclose problems in the strategic alliance negotiations, and failure to disclose the active consideration of an alternative method of raising capital. We have listed excerpts of the relevant statements in the margin.[3/]

[3/] 1. "This company is worth a hell of a lot more than $200.00 a share. It was then. It is now." (Wall Street Journal, Feb. 7, 1990) (quoting defendant Levin). Third Amended Complaint, ¶ 41.

2. "There may be four big industrial partners with one in Europe and two in Japan, or two in Europe and two in Japan and [an] American company." (Wall Street Journal, Nov. 1990) (exact date unspecified) (quoting defendant Ross). *Id.* ¶ 51.

3. The company would seek foreign investors to take a minority interest in subsidiaries as a means of alleviating debt without selling off assets. (Time Warner announcement, Nov. 19, 1990) (no direct quotation provided). *Id.* ¶ 48.

4. The company "continues to have serious talks that could lead to the sale of five or six separate minority stakes in its entertainment subsidiaries next year." (Wall Street Journal, (continued...)

1. Affirmative misrepresentations. We agree with the District Court that none of the statements constitutes an *affirmative* misrepresentation. Most of the statements reflect merely that talks are ongoing, and that Time Warner hopes that the talks will be successful. There is no suggestion that the factual assertions contained in any of these statements were false when the statements were made. As to the expressions of opinion and the projections contained in the statements, while not beyond the reach of the

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3/(...continued)

Nov. 30, 1990) (quoting defendant Ross). *Id.* ¶ 50.

5. The company "received and continue[s] to receive many expressions of interest in forming joint ventures of all of its businesses from all over the world." (Time Warner press release, Dec. 3, 1990). *Id.* ¶ 52.

6. "Management of Time Warner also has had discussions with potential partners on the mutual advantages of strategic alliances formed at the subsidiary level." (1990 SEC 10-K Statement). *Id.* ¶ 56.

7. Ross and Nicholas "are excited by the possibilities for growth that will increase shareholder value, expecially through strategic partnerships." (1990 Annual Report). *Id.* ¶ 57.

8. The company "was in talks with possible buyers of stakes in some of its entertainment businesses." (Ross, March 7, 1991). *Id.* ¶ 63.

9. Time Warner "was continuing talks with potential foreign partners.... We're not selling or buying.... We're partnering." (Nicholas, Mar. 15, 1991). *Id.*

10. Time Warner is "currently engaged in nearly two dozen discussions in Europe and Asia that could link most of the world's entertainment and media companies in a complex web of relationships.... We are making alliances at the subsidiary level with the partners keeping their national identities and bringing their respective strengths to bear." (Business Week, May 13, 1991) (quoting defendant Ross). *Id.* ¶ 66.

11. "[W]e are pursuing a number of innovative business ventures all over the world." (Time Warner public announcement, May 14, 1991). *Id.* ¶ 68.

securities laws, *see Virginia Bankshares, Inc.* v. *Sandberg*, 111 S. Ct. 2749, 2756-61 (1991) (proxy statements actionable under section 14(a)); *Goldman* v. *Belden*, 754 F.2d 1059, 1068-69 (2d Cir. 1985) (positive predictions actionable under section 10(b)), the complaint contains no allegations to support the inference that the defendants either did not have these favorable opinions on future prospects when they made the statements or that the favorable opinions were without a basis in fact.

2. Nondisclosure of problems in the strategic alliance negotiations. The allegations of nondisclosure are more serious. Plaintiffs' first theory of nondisclosure is that the defendants' statements hyping strategic alliances gave rise to a duty to disclose problems in the alliance negotiations as those problems developed. We agree that a duty to update opinions and projections may arise if the original opinions or projections have become misleading as the result of intervening events. *See In re Gulf Oil/Cities Service Tender Offer Litigation*, 725 F. Supp. 712, 745-49 (S.D.N.Y. 1989) (material misstatements or omissions adequately set forth alleging that defendants had expressed a strong interest in consummating a merger and had not disclosed a later "change of heart"); *In re Warner Communications Securities Litigation*, 618 F. Supp. 735, 752 (S.D.N.Y. 1985) (approving settlement), *aff'd*, 798 F.2d 35 (2d Cir. 1986). But, in this case, the attributed public statements lack the sort of definite positive projections that might require later correction. The statements suggest only the hope of any company, embarking on talks with multiple partners, that the talks would go well. No identified defendant stated that he thought deals would be struck by a certain date, or even that it was likely that deals would be struck at all. *Cf. In re Apple Computer Securities Litigation*, 886 F.2d 1109, 1118–19 (9th Cir. 1989) (Chairman of the Board stated that new computer product would be "phenomenally successful the first year out of the chute," etc.), *cert. denied*, 496 U.S. 943 (1990). These statements did not become materially misleading when the talks did not proceed well.[4/]

[4/] Although the statements are generally open-ended, there is one sense in which they have a solid core. The statements represent as

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3. Nondisclosure of alternative methods of raising capital. Still more serious is the allegation of a failure to disclose the simultaneous consideration of the rights offering as an alternative method of raising capital. As an initial matter, of course, a reasonable investor would probably have wanted to know of consideration of the rights offering. Though both the rights offering and strategic alliances would have brought capital into the corporation, the two acts would have directly opposite effects on the price of Time Warner stock. A successful strategic alliance, simultaneously opening new markets and reducing debt, would have improved the corporation's expected profit stream, and should have served to drive up the share price. An offering of new shares, in contrast, would dilute the ownership rights of existing shareholders, likely decrease dividends, and drive down the price of the stock.

But a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts. *See Basic Inc.* v. *Levinson*, 485 U.S. 224, 239 N.17 (1988); *Glazer* v. *Formica Corp.*, 964 F.2d 149, 157 (2d Cir. 1992). As Time Warner pointedly reminds us, we have not only emphasized the importance of ascertaining a duty to disclose when omissions are at issue but have also drawn a distinction between the concepts of a duty to disclose and materiality. *See Glazer*, 964 F.2d at 157. It appears, however, that the distinction has meaning only in certain contexts. For example, where the issue is whether an individual's relationship to information imposed upon him a duty to disclose, the inquiry as to his duty is quite distinct from the inquiry as to the information's materiality. *See Dirks* v. *SEC*, 463 U.S. 646 (1983). On the other hand, where the disclosure duty arises from the combination of a prior statement and a subsequent

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[4/](...continued)
fact that serious talks with multiple parties were ongoing. If this factual assertion ceased to be true, defendants would have had an obligation to update their earlier statements. But the complaint does not allege that the talks ever stopped or ceased to be "serious," just that they eventually went poorly.

event, which, if not disclosed, renders the prior statement false or misleading, the inquiries as to duty and materiality coalesce. The undisclosed information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available." *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). If a reasonable investor would so regard the omitted fact, it is difficult to imagine a circumstance where the prior statement would not be rendered misleading in the absence of disclosure. As *Glazer* makes clear, one circumstance creating a duty to disclose arises when disclosure is necessary to make prior statements not misleading. *Glazer*, 964 F.2d at 157 (citing *Roeder* v. *Alpha Industries, Inc.*, 814 F.2d 22, 26 (1st Cir. 1987)).

We have previously considered whether disclosure of one business plan required disclosure of considered alternatives in *Kronfeld* v. *TransWorld Airlines, Inc.*, 832 F.2d 726 (2d Cir. 1987), *cert. denied*, 485 U.S. 1007 (1988). In *Kronfeld*, the defendant, TWA's parent corporation, failed to disclose in the prospectus for a new issue of TWA stock that it was contemplating termination of its relationship with TWA. Because the prospectus discussed "in some detail the relationship between TWA" and the parent, *id.* at 735, we held that a fact question was presented as to whether it was materially misleading not to disclose the possibility of termination, *id.* at 736-37. In effect, the alternative, if disclosed, would have suggested to investors that the various guarantees extended from the parent of TWA might be meaningless. In the pending case, the District Court understood the obligation to disclose alternate business plans to be limited to the context of mutually exclusive alternatives. It is true that *Kronfeld* involved such alternatives—the TWA parent could not both maintain and terminate its relations with TWA—and that this case does not. Time Warner potentially could have raised all its needed capital from either strategic alliances or a rights offering, or it could have raised some part of the necessary capital using each approach.

We believe, however, that a disclosure duty limited to mutually exclusive alternatives is too narrow. A duty to disclose arises whenever a secret information renders prior public statements materially misleading, not merely when that information completely

negates the public statements. Time Warner's public statements could have been understood by reasonable investors to mean that the company hoped to solve the *entire* debt problem through strategic alliances. Having publicly hyped strategic alliances, Time Warner may have come under a duty to disclose facts that would place the statements concerning strategic alliances in a materially different light.

It is important to appreciate the limits of our disagreement with the District Court. We do not hold that whenever a corporation speaks, it must disclose every piece of information in its possession that could affect the price of its stock. Rather, we hold that when a corporation is pursuing a specific business goal and announces that goal as well as an intended approach for reaching it, it may come under an obligation to disclose other approaches to reaching the goal when those approaches are under active and serious consideration. Whether consideration of the alternate approach constitutes material information, and whether nondisclosure of the alternate approach renders the original disclosure misleading, remain questions for the trier of fact, and may be resolved by summary judgment when there is no disputed issue of material fact. We conclude here only that the allegations in the complaint of nondisclosure of the rights offering are sufficient to survive a motion to dismiss.

II. Scienter

As an alternative basis for its dismissal order, the District Court found that plaintiffs had failed to adequately plead scienter. Scienter is a necessary element of every 10b-5 action, and though it need not be plead with "great specificity," *Connecticut National Bank* v. *Fluor Corp.*, 808 F.2d 957, 962 (2d Cir. 1987) (quoting *Goldman* v. *Belden*, 754 F.2d 1059, 1070 (2d Cir. 1985)), the facts alleged in the complaint must "give[] rise to a 'strong inference' of fraudulent intent." *O'Brien* v. *National Property Analysts Partners*, 936 F.2d 674, 676 (2d Cir. 1991). We have recognized two distinct ways in which a plaintiff may plead scienter without direct knowledge of the defendant's state of mind. The first approach is to allege facts establishing a motive to commit fraud and an opportunity to do so. The second approach is to allege facts

constituting circumstantial evidence of either reckless or conscious behavior. *See Beck* v. *Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988), *overruled on other grounds by United States* v. *Indelicato*, 865 F.2d 1370 (2d Cir. 1989) (in banc). The District Court concluded that the complaint fell short under either approach.

A. Motive and opportunity

The difficulty with plaintiffs' motive and opportunity approach to scienter lies in the pleading of motive; no one doubts that the defendants had the opportunity, if they wished, to manipulate the price of Time Warner stock. Plaintiff's allegations concerning motive have shifted somewhat throughout the proceedings. Initially, plaintiffs emphasized that the defendants had embarked on a campaign to convince the public that Time Warner stock was worth in excess of $200 per share, so as to soften public criticism and avoid personal embarrassment stemming from their blocking of the Paramount tender offer. Plaintiffs now emphasize that defendants were motivated to misrepresent the status of the strategic alliance negotiations to avoid jeopardizing talks with prospective partners, and to withhold disclosure of consideration of the rights offering to maintain a high stock price prior to announcement of the new rights offering in order to lessen the dilutive effect. The complaint alleged the maintenance of an artificially high stock price (Third Amendment Complaint, ¶ 93), but relied on an inference for the motive of lessening the dilutive effect of the ultimately disclosed rights offering. The District Court found these proffered motives facially irrational, since Time Warner had no unilateral ability to cause prospective partners to invest and since, without strategic alliances, a rights offering, which would necessarily depress the stock price, was inevitable. Defendants make similar arguments on appeal; they also claims, that these motive theories are too speculative.

Whether plaintiffs' motive allegations, with respect to nondisclosure of the rights offering, are adequate to survive a motion to dismiss is a close question. On the one hand, it is surely true, as the District Court noted, that strategic alliances could not be compelled and that, once the rights offering was announced, the price of Time Warner stock would inevitably drop. On the other

hand, it is not clear, at least at this threshold stage of the lawsuit, that the defendants had nothing to gain by playing up strategic alliances while simultaneously keeping secret until the last moment the alleged active consideration of a rights offering. The unresolved issue is whether the effects of the alleged artificial raising of the stock price by the combination of the glowing reports of potential strategic alliances and the nondisclosure of the active consideration of a rights offering could reasonably have been expected by the company not to have been completely dissipated by the announcement of the rights offering, thereby enabling the company to set the rights offering price somewhat higher than would have been possible without the misleading statements and to lessen the dilutive effect of the offering.

Defendants ridicule plaintiffs' motive argument as "nonsensical," Brief for Appellees at 29, by arguing that the misleading statements about possible alliances all preceded the one-month period starting May 1, 1991, in which they are alleged to have been actively considering the rights offering. Thus, defendants contend, plaintiffs are alleging a conspiracy in which all of the overt acts occurred before the May 1 date that marks the start of the conspiracy. This argument is strong on rhetoric but insufficient to preclude all possibility of developing proof that a motive in fact existed. The pre-May 1 statements were not, as we have held, actionable when made. However, they arguably became misleading after May 1 when the rights offering was allegedly under active consideration and not disclosed. The failure to render the prior statements not misleading by disclosing consideration of the rights offering occurred after May 1. The close question is not whether any actionable nondisclosure occurred after May 1; the complaint adequately alleges that it did. The close question is whether the defendants are adequately alleged to have had a motive to benefit from the nondisclosure, thereby satisfying the scienter requirement.

The defendants are on somewhat sounder ground in faulting the plaintiffs for not articulating with either clarity or consistency their motive theory. Nevertheless, we think that a motive theory emerges with sufficient reasonable possibilities to withstand a motion to dismiss. With all inferences drawn in favor of the plaintiffs, it is arguable that the defendants acted in the belief that they could

somewhat reduce the degree of dilution by artificially enhancing the price of the stock. This could have happened if (a) the statements about strategic alliances, which became misleading upon nondisclosure of consideration of the rights offering, artificially increased the stock price, and (b) the effect of that increase was not fully dissipated by the announcement of the rights offering.[5/] If some artificial enhancement remained, the defendants would have been able to raise the needed capital at a higher rights offering price, thereby issuing fewer shares and lessening the dilutive effect (or raising more capital by issuing the same number of shares).

We recognize that the Supreme Court has proceeded on the assumption that "market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices." *See Basic, Inc.*, 485 U.S. at 247, n.24. Though confidence in the efficient markets hypothesis is not universally shared, *see Donald C. Langevoort, Theories, Assumptions, and Securities Regulation: Market Efficiency*

[5/] Presumably, announcement of a rights offering will tend to reduce a stock price by the extent to which the offering, if fully subscribed, dilutes the position of the original shareholders. For example, if a company with 1,000 outstanding shares selling at $100 a share raises $100,000 of new capital by a rights offering that issues 2,000 shares at a price of $50 a share, the original shareholders will own one-third (1,000 shares of 3,000 outstanding) of a company that should be worth $66.67 ($200,000/3,000). The question is whether an artificial enhancement of the pre-rights offering price to, say, $150 per share, thereby creating a post-rights offering company "worth" $250,000 can result in a post-rights offering stock price of somewhere between $83.33 ($250,000/3,000) and $66.67. If so, the company might decide to set the rights offering price somewhat above $50 in the expectation that it could raise the needed $100,000 by issuing somewhat less than 2,000 shares, thereby somewhat reducing the dilutive effect of the offering.

Revisited, 140 U. Pa. L. Rev. 851 (1992),[6] we do not intend to permit a scienter allegation to survive dismissal on the vague possibility that some irrational share purchasers might not comprehend disclosures made in the normal course by a company that has fully and timely discharged all its disclosure obligations. But the allegations here are that a company has not discharged its disclosure obligations and has permitted prior statements (concerning strategic alliances) to become misleading by a material nondisclosure (of the active consideration of a dilutive rights offering). In such circumstances, we consider the pleading sufficient to survive dismissal because, however efficiently markets may be thought to work when disclosure are proper, it is not beyond doubt that they may not *fully* correct for prior misleading information once a necessary disclosure has been made. Though, in many circumstances, a truthful correction might be expected promptly to alert the market to errors in prior statements, whether those erroneous prior statements were made willfully or innocently, it is possible, in some circumstances, that the embellishments of a deliberately false statement and the manner of its dissemination might leave its effects lingering in the market for some time, despite a correcting statement. In a case like the pending one, however, the issue is not whether the misleading aspect of the prior statement in fact lingered; it is only whether the plaintiffs can show that the defendants had a motive not to promptly correct the misleading aspect of the prior statement. Whether such a motive existed depends not on what any member of this panel believes, but on what the plaintiffs can prove.

Since the laws of economics have not yet achieved the status of the law gravity, we cannot say, on a motion to dismiss, that

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[6] Two critics have expressed their doubts in these colorful words: "If the efficient markets hypothesis was a publicly traded security, its price would be enormously volatile . . . [T]he stock in the [conventional] hypothesis . . . crashed along with the rest of the market on October 19, 1987. Its recovery has been less dramatic than the rest of the market." Andrei Shleifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, J. Econ. Persp. 19 (Spring 1990).

plaintiffs cannot prove that a motive existed. What cannot be determined from the pleadings is whether, in this instance, the defendants acted to maintain the stock price at an artificially enhanced value in the hope that it would not descend all the way to its "true" value upon announcement of the fact—consideration of the rights offering—that rendered the prior statements misleading. Whether some focused preliminary discovery will permit the matter to be resolved adversely to the plaintiffs on a motion for summary judgment remains to be determined.

B. Circumstantial evidence of conscious or reckless behavior

In contrast to the motive and opportunity approach, the complaint cannot be said to adequately plead scienter under the circumstantial evidence of conscious or reckless behavior approach, at least with respect to nondisclosure of the rights offering. There may be adequate allegations of scienter as to nondisclosure of difficulties in the search for strategic alliance, but we have held that the complaint alleges no actionable nondisclosure in this regard. As to the nondisclosure of the rights offering, the complaint lacks allegations that give rise to a strong inference that Time Warner began to consider the rights offering significantly before it was announced. A single mention of a newspaper report alleged to state that "Time Warner has been quietly working for months on its plans for the rights offering," Third Amended Complaint ¶ 81, is not adequate. Plaintiffs, however, have proposed to amend their complaint to supplement this necessary allegation, and this amendment may well be adequate.[7/] We will leave it to the District Court to determine whether to allow plaintiffs the opportunity to amend their complaint so as to support an additional theory of

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[7/] Specifically, plaintiffs state that they would allege that as early as November 1990, the rights offering was under consideration. This allegation is grounded in a report, contained in the material discovered in the Delaware action and provided to plaintiffs, of a meeting at which Merrill Lynch presented Time Warner executives with a proposal for an equity offering designed to extinguish certain classes of preferred stock.

scienter, and, if this opportunity is provided, to determine in the first instance whether such a theory is adequate.[8/]

III. State Law claims

Our reinstatement of the section 10(b) claim mandates reinstatement of the state law fraud claim as well. The basis for the dismissal of the state law fraud claim was the failure to plead a misrepresentation or omission of a material fact, a requirement under New York law. *See Miller* v. *Bankers Trust Co.*, 615 F.2d 68, 80 (2d Cir. 1980), *cert. denied*, 449 U.S. 1123 (1981); *Atlantic Welding Services Inc.* v. *Westchester Steel Fabricators Corp.*, 173 A.D.2d 1073, 1074, 570 N.Y.S.2d 410, 412 (3d Dep't 1991). We have ruled that the complaint adequately pleads material omissions.

However, plaintiffs' negligent misrepresentation claim was properly dismissed. With few exceptions, New York strictly limits negligent misrepresentation claims to situations involving "actual privity of contract between the parties or a relationship so close as to approach that of privity." *Ossining Union Free School District* v. *Anderson LaRocca Anderson*, 73 N.Y.2d 417, 419, 541 N.Y.S.2d 335, 335 (1989). Plaintiffs do not allege privity of contract. The exceptions, embracing cases in which defendants make negligent misrepresentations intending that identified persons rely on the misrepresentations, have been held not to apply to the investing public. *See In re Par Pharmaceutical, Inc. Securities Litigation*, 773 F. Supp. 668, 686 (S.D.N.Y. 1990).

Conclusion

We reverse the order of the District Court dismissing counts one and two of the complaint, and affirm the order dismissing count three of the complaint. The case is remand for further proceedings consistent with this opinion.

[8/] Since the claim we reinstate concerns only nondisclosure of the rights offering between May 1, 1991, and June 6, 1991, any class to be certified would include, at most, those who purchased shares in that period.

In re: Time Warner, Inc.
#92-7816

WINTER, Circuit Judge, dissenting:

In respectfully dissent. In my view, Time Warner's purported scheme to float a variable-price rights offering at an artificially inflated price is at odds with many long-standing assumptions of the securities laws and thus does not suffice to establish scienter for purposes of a Rule 12(b)(6) motion. Moreover, it is expressly contradicted by the complaints.

I.

First, the area of agreement. I agree that the allegation that Time Warner's failure to disclose active consideration of the variable-price rights offering was material in that it rendered prior statements arguably misleading. Under *Kronfeld* v. TWA, 832 F.2d 726 (2d Cir. 1987), *cert. denied*, 485 U.S. 1007 (1988), a trier may find that the disclosure of one possible financial strategy (or strategies) is misleading when another strategy with substantially more negative implications for investors is also being seriously considered. In *Kronfeld*, a failure to disclose consideration of the complete severing of ties with a subsidiary was held to be material in light of the disclosure of less drastic strategies. *Id.* at 736. Because the drastic severance alternative had yet to be considered by the parent's board, *Kronfeld* establishes a rather inclusive test of materiality, and the complaint here alleges facts more compelling than those in *Kronfeld*. It therefore cannot be dismissed on materiality grounds.

Because I view the complaints in a somewhat different light than my colleagues, I will set out in some detail what I regard to be the pertinent allegations. Time Warner had taken on considerable debt and had a balloon payment coming up. This was not news to the market for its shares. Over the course of time, various officers of Time Warner made statements regarding strategic alliance conversations and the benefits of such alliances. These benefits sometimes involve the penetration of new markets or the development of new products, frequently involved the

infusion of cash that would be available to pay off the debt, and sometimes involved both. Analysts responded favorably, noting that they anticipated the consummation of strategic alliances, sales of Time Warner assets, or other "restructurings," any of which would enable the company to meet its debt payments.

Given the somewhat loose use of the term "dilution" in this litigation and my view of the scienter issue set forth *infra*, two matters must be emphasized. First, when a debt-ridden company raises cash by a strategic alliance, a sale of an asset, or a restructuring, the parties providing the cash will demand interests in the company that dilute the existing common shares in the sense that it will reduce their share of equity. Indeed, it is inconceivable that any strategic alliance could have been consummated by Time Warner without sharing, and diluting, equity interests. Second, investors who do not care about control also do not care about dilution. They care about share value, and that value may (in this case would) increase as a result of a diluting infusion of cash brought about by a strategic alliance or even by an issue of additional common stock.

The failure to consummate a strategic alliance and subsequent resort to the issuance of new shares, therefore, would, if the offering here was a traditional offering of common shares, be dilutive but not injurious. Indeed, some of the analysts quoted by the complaint for the purpose of establishing misrepresentations contemplated assets sales that would dilute the equity by shrinking it or restructurings that might include the issuance of more dilutive shares. These analysts nevertheless expected share value to increase. In my view, therefore, Time Warner's failure to disclose active consideration of an equity offering did not make its prior statements misleading.

However, the offering here was not your standard equity offering. The variable-price rights offering—although not consummated, it is the offering that allegedly rendered prior statements misleading—was restricted to existing shareholders. This was news in light of the prior statements because it indicated that outside capital was not available. It thus indicated that the only source of capital available for the debt payments were the locked-in shareholders of Time Warner who might lose all if the company defaulted on the debt. Moreover, the variable-price rights offering

was dilutive but in a very different sense from that indicated by my colleagues. If all shareholders exercised their rights, each would purchase one new share for $105. If only 60% exercised the rights, those shareholders would purchase 1-2/3 shares for $63. As the complaints allege, therefore, the offering was coercive because shareholders hoping to minimize their losses would feel compelled to come up with fresh money. Unlike an infusion of capital from outside that would dilute but also benefit shareholders, this new issue of equity would necessarily lessen the value of the common shares because existing shareholders had either to put up more money or to incur a disproportionate loss in value. In light of the prior statements, therefore, active consideration of the variable-price option should have been disclosed under *Kronfeld*, 832 F.2d at 737.

II.

My disagreement with my colleagues concerns the complaints' allegations with regard to scienter, or in this case motive for the alleged failure to make timely disclosure. There is certainly no self-evident motive. The variable-rice rights offering was a drastic step, to be sure, and very bad news, but the timing of the announcement seems rather irrelevant. The complaints allege that appellees failed to make early disclosure because of the fear that potential partners would be scared off by the bad news. That is implausible, however. News that Time Warner could raise fresh cash from its shareholders would be welcome news to potential partners concerned about the burden of debt. That news thus might cause negotiations closer to agreement to succeed. It appears, however, that no alliance conversations were ever that close to an agreement.

The scenario relied upon by my colleagues to establish motive is that Time Warner management failed to disclose consideration of the variable-price rights offering to inflate the price at which that offering could be sold so that the dilutive effect would be minimized. The legal and logical flaws in this scenario seem rather plentiful. As a threshold matter, the complaints, as discussed *infra*, at times contradict it. This scenario also was not argued in the

district court, its source being a single paragraph in appellants' 49-page brief in this court.

Most important, the scenario is wholly implausible in light of the nature of the variable-price rights offering. Time Warner management was not seeking to minimize the dilutive effect on existing shareholders. To the contrary, as the complaints vigorously allege and as discussed *supra*, variable-price rights offering created a disproportionate dilutive effect on non-exercising shareholders as a means of coercing shareholders to exercise the rights. The notion that the existing shareholders would continue to rely upon long-gone statements regarding fresh capital in the face of the coercive rights offering is entirely far-fetched. The complaints allege in great detail that the rights offering "shocked the investment community," was viewed by analysts as an admission that Time Warner was unable to find fresh money from outside, and had "ang[ered]" shareholders. How the management of Time Warner might have expected any other reaction, much less continued faith in weeks-old statements that outside capital was available, defies commons sense. The very existence of the variable-price rights offering was a tangible, high-profile, and unmistakable negation of the earlier statements. That indeed is the reason that a failure to make timely disclosure is a material omission. *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

Moreover, the management of Time Warner knew at all pertinent times that such an offering had to be preceded by the filing of a registration statement with the SEC followed by a statutory waiting period. Securities Act of 1933, § 5, 15 U.S.C. § 77(e) (1988); *id.* § 8(a), 15 U.S.C. § 77h(a) (1988). That registration statement would have to reveal the failure of the strategic alliance talks and the fact that holders of Time Warner's common shares who would not or could not come up with more money would find their interests diluted. Securities Act of 1933, § 7(a) 15 U.S.C. § 77g(a) Supp. 1991) & Sched. A. That information would become public when filed, and investors would have several days to assimilate it before the rights offering could be sold. When it was filed on June 6, the registration statement, in the words of one complaint, "shocked the investment community," while by its own

terms the registration statement could not be effective before June 17.

The scenario posits a management that expects that the disclosure of the failure of the strategic alliance conversations and resort to a coercive rights offering would not be fully assimilated by shareholders during the waiting period. It also posits that a substantial number of shareholders would continue to give credence to statements that were weeks old and flatly contradicted by the registration statement.

My colleagues express skepticism about the usefulness of the efficient market hypothesis (while quoting a rather uncritical acceptance of it by the Supreme Court) in *Basic, Inc.* v. *Levison*, 485 U.S. 224, 246–27 (1988). However, the notion that markets impound available information relatively promptly in share prices, at least in widely traded companies, pervades securities law. Most pertinent is the statutory provision for a waiting period after the filing of a registration statement. One purpose of the waiting period is to allow ample time for the information contained in the statement to be absorbed by investors. Indeed, that is why acceleration of the validity of a registration statement depends in part on whether the information contained in it has been widely disseminated. SEC Reg. C, Rule 461(b), 17 C.F.R. § 230.461(b) (1993).

In *Texas Gulf Sulphur*, we indicated that insider might trade on previously confidential information within a reasonable period of time after information was disseminated on the Dow Jones tape. 401 F.2d at 854. Although no doubt unintended, my colleagues' belief that the market cannot fully absorb what was headline information in the financial press over a period of many days would seem quite inconsistent with *Texas Gulf Sulphur*. Moreover, the SEC's adoption of Forms S-3 was based on the view that filings with the SEC by widely traded companies are quickly absorbed in the price of shares. *See* Adopted of Integrated Disclosure System, Securities Act Release No. 6383, 47 Fed. Reg. 11,380 (1982).

Finally, although there are weak forms of the efficient market hypothesis, a fairly strong form has been adopted by the Supreme Court. *See Basic, Inc.*, 485 U.S. at 246 ("Recent empirical studies have tended to confirm Congress' premise that the market price of shares traded on well-developed markets reflects all available information. . ."). Indeed, one of the striking ironies of my

colleagues' ruling is that the complaints in the present matter stress the efficiency of the market for Time Warner shares and never allege event he possibility that the strategic alliance statements had, or could have had, a lingering effect after June 6. To the contrary, one complaint alleges that the market "reacted promptly to disclosure" that the quest for strategic partners had failed. While my colleagues suggest that the efficient market hypothesis is flawed, each of the complaints alleges it as an operative fact so far as Time Warner stock "traded on an active and efficient market," or uses similar language. Of course, these allegations are intended to establish appellants' reliance upon the material omission. *See Basic, Inc.*, 485 U.S. at 243. The result of the present ruling is that appellants are allowed to establish reliance in their pleadings by stressing the efficiency of the market in Time Warner's shares while establishing scienter by positing a market that cannot absorb a current registration statement's negation of weeks-old information. This inconsistency seems rather stark in light of the facts that the statements concerning strategic alliance conversations promised no success while the announcement of the variable-price rights offering unambiguously disclosed the failure of those conversations. Nevertheless, plaintiffs avoid dismissal on the claim that investors would continue to harbor unwarranted optimism as a result of the earlier statements notwithstanding the company's later straightforward admission of failure.

It is not my position that one must simply assume the efficiency of markets, although the strength of such an assumption is greatest in the case of widely traded companies, like Time Warner, whose affairs are closely followed in the financial press. However, allegations of delays in the absorption of information, the existence of "bubbles," or other inefficiencies should be made with some precision. In the present matter critical ambiguities—as well as the internal contradiction concerning the issue of reliance noted above—shroud my colleagues' views of the operation of capita markets. For example, the present ruling suggests, as noted, that the legally designated waiting period is too short for the market to absorb information in a registration statement. If so, how can we be confident that disclosure on May 1 would have led to any greater absorption?

The only description given of the supposed imperfection is a suggestion that markets may work efficiently "when disclosures are proper [but] it is not beyond doubt that they may not *fully* correct for prior misleading information once a necessary disclosure has been made." (emphasis in original) I doubt the validity of this proposition. It appears to posit that if A, Inc. truthfully projects high earnings and later states, again truthfully, that it now expects only to break even, the market can absorb the downgrading. It also seems to posit that if A, Inc. falsely projects high earnings but later states truthfully that it now expects only to break even, the market cannot fully absorb the downgrading. This does not seem plausible to me.

Nor can I find an explanation of why the inefficiency of the market is only on the up rather than on the down side. Why doesn't the dashing of hopes as to strategic alliances and the adoption of a coercive, variable-price rights offering lead to overcorrection instead of undercorrection? More pertinently, why would Time Warner management expect—actually, count on—undercorrection?

Neither Time Warner nor its shareholders, who must pay the costs of defending and settling this action, profited from any delay in announcing the variable-price rights offering. The argument regarding a motive for such delay posits a scenario that is inconsistent with assumptions underlying securities law, statements in the complaint, and any plausible understanding of the operation of capital markets. I would affirm the dismissal of the complaint.

IN RE TIME WARNER INC. SECURITIES LITIGATION

This Document Relates to: all Actions
No. 91 Civ. 4081 (MEL).
United States District Court, S.D. New York
July 10, 1992

Milberg Weiss Bershad Specthrie & Lerach, Esqs., David J. Bershad, Sol Schreiber, Jerome M. Congress, Lee S. Shalov, James E. Tullman, of counsel, New York City, Much Shelist Freed Denenberg & Amend, P.C., Michael J. Freed, Joseph D. Ament, Ellyn M. Lansing, of counsel, Chicago, Ill. and Kaufman Malchman Kaufmann & Kirby, Roger W. Kirby, of counsel, New York City, for plaintiffs.

Paul, Weiss, Rifkind, Wharton & Garrison, Esqs., Stuart Robinowitz, Alisa D. Shudofsky, Jonathan J. Freedman, Michael E. Gertzman, Isaac D. Corre, Matthew L. Levine, of counsel, New York City, for defendants.

OPINION

LASKER, District Judge.

*1 Plaintiffs, investors in defendant Time Warner Inc.'s stock, move for reargument of the opinion and order dated May 29, 1992 that dismissed their securities fraud complaint.

Plaintiffs assert several defects in the earlier opinion: first, that the ruling "misconstrued defendants' statements concerning strategic alliances as constituting adequate disclosure...." Pl. Br. at 2. Second, that the opinion "erroneously concluded that the Complaint failed to allege scienter on the part of the individual defendants," while failing to address one scienter theory raised at oral argument. Pl. Br. at 3. Third, that the opinion "improperly denied plaintiffs the opportunity to amend and replead," particularly because the opinion overstated the extent and value of discovery plaintiffs had enjoyed and the significance of the two previous amendments to the complaint. Pl. Br. at 3–4.

The first argument goes to the extent statements made by defendants were misleading, either when made or subsequently. That issue was directly and extensively addressed in the earlier decision. See Opinion at 15–18. Plaintiffs have not presented new information or law not addressed earlier; they simply challenge the opinion's reading of the complaint and its conclusions as to the legally permissible inferences that follow from the facts alleged.[1/]

Plaintiffs' second argument challenges the May 29 ruling as to the complaint's scienter allegations. Because the complaint was dismissed both pursuant to Fed.R.Civ.P. 12(b)(6) on non-scienter grounds and pursuant to Fed.R.Civ.P. 9(b) due, in part, to the insufficiency of pleadings of scienter, plaintiffs must prevail both as to scienter and as to the Rule 12(b) dismissal to prevail on this motion. They fail on both counts. As to scienter, they simply reiterate the view that their pleadings raise a sufficient inference, without identifying legal or factual grounds that earlier were overlooked. None of the bases for inferring scienter which were presented earlier or in argument here create the requisite "strong inference" of fraudulent intent.

Third, plaintiffs object that they are entitled, or should be granted leave, to replead. They object that the earlier decision overstates the degree of discovery and the opportunity for informed amendment of their complaint that plaintiffs have had.

The primary—and sufficient—reason for denying leave to amend was simply that the dismissal was fundamentally pursuant to Rule 12(b)(6) for failure to identify any material misstatements or omissions subject to a duty to disclose, rather than Rule 9(b). The additional discussion of leave to amend as to the Rule 9(b) grounds for dismissal was in the nature of a "backstop" in the event some

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[1/] The earlier decision did not "overlook[ ] the controlling precedent of Basic Inc. v. Levinson," 485 U.S. 224 (1988), as suggested by plaintiffs. Basic discusses the point at which advancing merger negotiations become material within the meaning of the securities laws, 485 U.S. at 239–241. This legal background was briefed by the parties and known to the court, and, although not cited, is consistent with the analysis contained in the earlier opinion.

isolated elements of the complaint could be viewed as having been dismissed solely pursuant to Rule 9(b). Moreover, the thrust of that discussion—that plaintiffs' complaint was prepared by sophisticated counsel, was extremely well drafted and appeared unlikely to be susceptible to improvement—is not seriously challenged by the plaintiffs'.

*2 Indeed, when asked at oral argument what additional facts could be repled if leave to amend were granted, plaintiffs mentioned only (1) more detailed reference to investment bank activity in April or May; (2) "better articulat[ion]" of a duty to update earlier statements; (3) "fleshed out" scienter allegations; and (4) an increase in the likelihood of a stock offering throughout the class period. The first and fourth points were considered in the earlier opinion at 16–17. A "better articulation" of a duty or unspecified "fleshed out" scienter allegations also would not alter the result obtained before.

Although the earlier opinion observed that plaintiffs had enjoyed "fairly substantial although not complete discovery," Opinion at 33, that was but one factor going to the determination not to allow repleading, and of course the absence of significant discovery is hardly pertinent to the sufficiency of a complaint, which ordinarily is prepared without the benefit of any discovery whatsoever.

Like many motions to reargue, in the last analysis the motion seems based primarily on a belief that the decision is erroneous. The remedy, of course, is to appeal. If an appeal is taken it will either terminate the case or clarify the applicability of the law to the facts at hand.

In sum, because plaintiffs have not identified legal or factual considerations overlooked in the earlier decision, the motion to reargue is denied.

It is so ordered.

In re TIME WARNER INC. SECURITIES LITIGATION.

This document relates to: all actions

No. 91 Civ. 4081 (MEL.)

United States District Court
S.D. New York

May 29, 1992.

Investors brought securities fraud action against corporate officers. The District Court, Lasker, J., held that: (1) statements alleged in the complaint were not actionable, and (2) dismissal would be with prejudice.

Motion to dismiss granted.

Milberg Weiss Bershad Specthrie & Lerach (David J. Bershad, Sol Schreiber, Deborah Clark-Weintraub, of counsel, New York City, Much Shelist Freed Denenberg & Ament, P.C. (Michael J. Freed, Joseph D. Ament, Ellyn M. Lansing, of counsel), Chicago, Ill., and Kaufman Malchman Kaufmann & Kirby (Roger W. Kirby, of counsel), New York City, for plaintiffs.

Paul, Weiss, Rifkind, Wharton & Garrison (Stuart Robinowitz, Arthur L. Liman, Alisa D. Shudofsky, Jonathan J. Freedman, Michael E. Gertzman, Isaac D. Corre, Matthew L. Levin, of counsel), New York City, for defendants.

LASKER, District Judge

In this suit alleging securities fraud, common law fraud, and negligent misrepresentation, the defendants, Time Warner Inc. and

four individual officers of the company,[2] move to dismiss the amended class action complaint[3] under Rules 9(b) and 12(b)(6), Fed. R. Civ. P., on the grounds that plaintiffs have alleged neither material misstatements nor material omissions and that the complaint does not allege scienter on the part of defendants.

The motion is granted.

III.

The events giving rise to the complaint followed the celebrated, or notorious, creation of Time Warner through the former Time, Inc.'s 1989 leveraged buyout of the former Warner Communications, Inc., which was consummated to defeat a competing $200 per share tender offer for Time from Paramount Communications, Inc., and which imposed a heavy debt load on Time Warner. Despite Time's and Warner's representations before the merger that shares of the combined company would have a value over $200, stock prices fell substantially below that level following the merger.

Against this background, the complaint alleges, Time Warner and the individual defendants misled purchasers of its stock during the asserted class period of December 12, 1990 through June 7, 1991 by falsely claiming that the company was undervalued and that the intrinsic value of its shares was far higher than the market reflected, particularly because, the company claimed, it was negotiating "strategic alliances" in which foreign businesses would acquire minority shares in Time Warner subsidiaries, and thereby would provided Time Warner with needed capital and enhanced

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[2] The individual defendants are Steven J. Ross (Time Warner Chairman and co-Chief Executive during the class period), N.J. Nicholas (President and co-Chief Executive during the class period), Gerald M. Levin (Vice Chairman and Director during the class period), and Bert W. Wasserman (Director, Executive Vice President and Chief Financial Officer during the class period).

[3] A motion for class certification has been filed but not ruled on pending determination of this motion to dismiss.

global prospects. The complaint alleges that these claims were false and were inconsistent with the defendants' knowledge, which they fraudulently omitted to reveal, that the strategic alliances were unlikely to occur and that the company was considering an additional stock offering that it knew was inevitable and would further dilute the value of existing Time Warner shares. Compl. ¶ 95. The alleged motivation for this misleading behavior was defendants' desire "to maintain the impression that Time Warner was well positioned to achieve the generous share value which they had represented would be recognized following the merger of Time and Warner,"Compl. ¶ 22, and their desire "to dispel the public perception created by the Company's continuing losses and enormous debt load that the merger injured the Company." *Id.*

During the class period, Time Warner did not mention the possibility of a new stock offering. Nevertheless, rumors of such an offering circulated on June 5, 1991, and Time Warner stock fell $6.25 to a closing price of $110.75 per share. On June 6 Time Warner announced its intention to make a variable-price stock offering of approximately 34.5 million shares to add to the 57.8 million then-existing shares. Time Warner stock closed on June 6 at $99.50 per share. On June 7 it closed at $94.625. When it became apparent that this initial plan would not succeed, Time Warner on July 12, 1991 announced a fixed-price offering. The July 12 closing price was $89.75 per share.

According to plaintiffs, "Defendants' concession that they could not achieve such strategic alliances and their implementation of a dilutive rights offering which have diminished the value of Time Warner stock have defeated the expectations of Time Warner investors who had purchased the stock in reliance on management assurances that the entertainment giant created by the merger would generate synergies and attract outside investment capital at levels which would justify and validate the pivotal decisions undertaken by the Time directors in rejecting the $200 per share Paramount offer." Compl. ¶ 22. Time Warner's repeated indication during the class period that it was pursuing strategic alliances, coupled with its failure to disclose its consideration of a possible rights offering and the continuing difficulties attracting partners who could relieve its heavy debt, is alleged to have inflated the price of Time Warner

stock artificially, with the result that investors who purchased shares during the class period were injured by the inevitable decline in the stock's price that ensued.

The complaint objects to several categories of statements, maintaining that they were materially misleading and that they rendered Time Warner's failure to reveal information concerning a possible stock offering materially misleading: first, statements by individual defendants that were quoted in the popular media or were released by Time Warner, and that are quoted in the complaint; second, unattributed statements quoted in the media and attributed to "Time Warner officials," that also are quoted in the complaint; third, unspecified but allegedly frequent information contacts with persons who are not specifically identified in the complaint but are alleged to be influential Wall Street figures. Of the last category it is said that the statements were part of a Time Warner scheme to "provide[ ] information to securities analysts and others in order to promote the Company and purportedly inform the investment community of the current status and near and long-term prospects of the Company," Compl. ¶ 6, in support of Time Warner's efforts to gain market credibility. As evidence of Time Warner's attempt to influence the market in this way, the complaint cites analysts' reports and recommendations and media reports that suggest that Time Warner officials provide information underlying the reports.

A. Statements by Time Warner or Individual Defendants

The complaint recites statements made directly by the company or the individual defendants both before and during the class period, which, it alleges, created false expectations of imminent strategic alliances that would improve the company's outlook and stock price, and which even if true at one time gave rise to an ongoing duty on the part of Time Warner to inform investors if and when those expectations were unjustified.

Defendant Gerald Levin was quoted in the February 7, 1990 *Wall Street Journal* (ten months before the class period) as saying:

> The combination of Warner and Time, Inc. assets is proving to be a very sturdy and growth-oriented set of businesses. This company is worth a hell of a lot more than

> $200.00 a share. It was then. It is now. Given the expansion opportunities, particularly in terms of geography and technology, the company would have been undersold, and that's truer today than it was last spring.

Compl. ¶ 41.

On November 30, 1990 (still before the beginning of the class period), the *Wall Street Journal* reported that defendant Steven Ross stated that Time Warner "continues to have serious talks that could lead to the sale of five or six separate minority stakes in its entertainment subsidiaries next year [1991] . . . we want strategic alliances with partners thinking the same way we are." Compl. ¶ 50. The *Wall Street Journal* also reported, on a date unspecified in the complaint, that Ross stated in November 1990, "There may be four big industrial partners with one in Europe and two in Japan, or two in Europe and two in Japan. . . ." Compl ¶ 51. And on December 3, 1990, Time Warner issued a press release stating that it had "received and continued to receive many expressions of interest in forming joint ventures all over the world." Compl. ¶ 52.

Plaintiffs also complain of a number of statements during the class period. The company's 1990 10-K Statement filed with the Securities Exchange Commission (SEC) reported: "Management of Time Warner also has had discussions with potential partners on the mutual advantages of strategic alliances formed at the subsidiary level." Compl. ¶ 56. In the 1990 Annual Report, Ross and defendant N.J. Nicholas similarly claimed to be "excited by the possibilities for growth that will increase shareholder value, especially through strategic partnerships that open opportunities no single company could realize on its own . . . Time Warner has spent a good deal of the past year discussing with potential partners the mutual advantages we can derive from well-planned and strategically-executed alliances at the subsidiary level."

On March 7, 1991, Ross stated that the "company was in talks with possible buyers of stakes in some of its entertainment businesses," while on March 15 Nicholas said the company was "continuing talks with potential foreign partners," and added, "We're not selling or buying. We're partnering." Compl. ¶ 63. On April 11, Ross addressed an entertainment industry conference and stressed the need for entertainment corporations to develop "strategic alliances" "to provide access to new products or the

markets that would otherwise be closed or difficult to penetrate." Compl. ¶ 64.

The May 13, 1991 issued of *Business Week* quoted Ross as saying that Time Warner was "currently engaged in nearly two dozen discussions in Europe and Asia that could link most of the world's entertainment and media companies in a complex web of relationships." Ross further stated in the same interview, "Our objective is to build global partnerships . . . We are making alliances at the subsidiary level with the partners keeping their national identities and bringing their respective strengths to bear." Compl. ¶ 66.

B. Statements Attributed to Unnamed Time Warner Sources

An unnamed Time Warner spokesman said on February 15, 1991 that the company had "said all along that we are interested in the concept of international partnership, and we have been talking with many interested parties. . . . Now we are in the process of selecting from among them those that share our vision." Compl. ¶ 59. On February 20, the complaint alleges, "Time Warner stated" that it was still negotiating strategic alliances with "a significant number of parties." Compl. ¶ 60.

On April 19,1991, an unidentified Time Warner spokesman stated that talks regarding possible mergers with Time Warner subsidiaries had "intensified." Compl. ¶ 65.

Finally, a Time Warner spokesman on June 5, 1991 "refused to comment" on rumors that Time Warner was contemplating a stock offering, and stated that the "company has been saying and continues to say that discussions to form partnerships are ongoing." Compl. ¶ 72. Time Warner announced its new offering the next day.

C. Analysts' and Media Reports Allegedly Influenced by Time Warner Informal Contacts

The complaint recites a number of media reports and market analysts' recommendations which, it maintains, support an inference that Time Warner informally disseminated sham

information" as to its prospects in an attempt to enhance the shares of its stock.

For example, on October 23, 1990 (before the class period), Merrill Lynch issued an analyst's report recommending the purchase of Time Warner stock because Time Warner "indicated that it has had serious negotiations concerning the sale of an interest in some of its cable systems . . . and continues to explore joint ventures with Japanese, European, and U.S. companies which would help Time Warner reduce its debt." Compl. ¶ 44. The same day, the *Wall Street Journal* reported that the company was "seeking partners proffering new cash to whittle its debt." Compl. ¶ 45. Morgan Stanley and Smith Barney issued similar reports and "buy" recommendations in late October, each of which stressed the potential of "strategic alliances" or a "restructuring involving joint venture partners"to enable Time Warner to reduce its debt load. Compl. ¶¶ 46, 47.

On November 27, 1990, still before the class period, Shearson Lehman issued a positive analyst's report that similarly stressed the potential benefits, including debt reduction, of strategic alliances believed to be under negotiation. The report stated, "Management has said that those negotiations involve the potential sale of minority equity interests in Time Warner assets." Compl. ¶ 49.

On December 12, 1990, at the beginning of the class period, the *Wall Street Journal* reported that Time Warner was engaged in "serious talks" toward strategic alliances. Compl. ¶ 54. On February 13, 1991, the *Journal* reported that Time Warner appeared to be closer to completing "a strategic alliance with one or more partners that would bring cash into the company while opening new world markets to Time Warner." The same story reported that Ross and Nicholas had "been globe-trotting since last year talking to potential partners." Compl. ¶ 58.

Several similar analysts' statements were issued in February 1991. On February 13, for example, Donaldson Lufkin & Jenrette Securities Corp. issued a "buy" rating on Time Warner, stating, "We are recommending purchase of Time Warner because the shares are selling at a 54% discount to the underlying value of the company's assets, and we assign a high probability to a restructuring within a year that would close that discount." Compl. ¶ 69(i). Two days later Wertheim Schroeder issued a similar

recommendation, noting, "We continue to expect an asset sale, joint venture or other major restructuring some time this year." Compl. ¶ 69(ii). On February 20, Wertheim Schroeder, in a report which referred to a meeting with Time Warner management, reported further that Time Warner "continues to be in discussion with 'a significant number of parties' regarding strategic alliances. Working aggressively, [Time Warner] expects to complete a deal in 1991." Compl. ¶ 69(iii). On February 25, Kidder, Peabody also strongly recommended Time Warner stock, noting that Time Warner management had reiterated that it had "significant conversations with a variety of interested parties to pursue possible strategic alliances." Compl. ¶ 69(iv). Similar reports were issued by different brokerages during March and April, culminating in an April 19, 1991 report by Wertheim Schroeder that discussions had intensified since February, and that there should be some definite announcement by year-end. Compl. ¶ 69(ix).

The May 13, 1991 *Business Week* article that included statements by Ross also opined as to the possible effects of successful strategic alliances for Time Warner, stating that by "bringing in billions of dollars in new equity, Time Warner would make Wall Street happy and help ratchet Time Warner stock up. . ." Compl. ¶ 67. Apparently from the same article, the complaint contains the quotation, "'The talks are like an auction with all kinds of assets being offered up,' stated one European reportedly involved in one set of negotiations. 'Nothing is off-limits to Time Warner.'" *Id.*

* * * * * *

As noted above, on June 5 an unnamed Time Warner spokesman refused to comment on rumors of a new offering and reiterated the company's public statement that "discussions to form partnerships are ongoing." Compl. ¶ 72. The next day, Time Warner announced its first proposed new stock offering, and the price of its stock plummeted.

The complaint contains standard recitals of defendants' scienter, supported by reference to the individual defendants' responsibilities for the company's significant decisions and by the strategic subject of the omissions and statements alleged. In support of their

contention that Time Warner secretly was planning its offering throughout the class period, plaintiffs point to a Reuters report on June 6, 1991 that the company had been working for months on a possible offering, Compl. ¶ 81, to the apparent inability of Time Warner to achieve an acceptable strategic alliance as an indicator of the need to raise capital through a stock offering, Compl. ¶ 84, and to the existence of a Merrill Lynch plan for a possible "equity restructuring" submitted to Time Warner on November 15, 1990. Exhibit A to letter to Court from Sol Schreiber, Esq., Jan. 2, 1992 (filed under seal; obtained through discovery while motion was pending).

IV.

Section 10(b) of the Securities Exchange Act of 1934 states that it is unlawful for any person "To use or employ, in connection with the purchase or sale of any security . . ., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate. . . ." 15 U.S.C. § 78(b) (1988). Rule 10b-5 of the Securities and Exchange Commission, promulgated to implement § 10(b), provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,
>
> . . . in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1991).

To state a viable claim under § 10(b) and Rule 10b-5, a complaint must allege that "in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information and that plaintiff's reliance on defendant's actions caused him injury." *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*, 754

F.2d 57, 61 (2d Cir. 1985). *See also Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976).*

Time Warner and the individual defendants argue that the complaint fails to allege statements or omissions by defendants which are or were misleading, that it inadequately alleges scienter, and that it fails to meet the pleading requirements of Rule 9(b), Fed. R. Civ. P., that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Defendants further argue that the complaint's state law claims should be dismissed, either pursuant to Rules 9(b) and 12(b)(6), Fed. R. Civ. P., or for want of pendent jurisdiction in the event the federal claims are dismissed. The defendants' presentation is persuasive.

A. Defendants' Material Misstatements or Omissions

The complaint supports the proposition that Time Warner and its officials during the class period tried to drum up enthusiasm for Time Warner stock by proclaiming the advantages possible "strategic alliances" could offer the company and its would-be partners and by reporting that negotiations were underway. The sequence of events alleged in the complaint, bearing in mind the generosity with which inferences are to be drawn in plaintiffs' favor on motions to dismiss, also adequately supports the inference that Time Warner officials were considering a stock offering during the class period but did not reveal that fact or any difficulty Time Warner may have been experiencing in its strategic alliance negotiations. Nevertheless, the complaint fails to allege either material misstatements or material omissions chargeable to defendants which were subject to a duty to disclose.

Only statements attributable to the defendants, or omissions by them, can support the claims against them. For reasons discussed below, neither the alleged statements by anonymous Time Warner sources which are quoted in the complaint nor analysts' and journalists' reports allegedly based on information gleaned from Time Warner sources may be attributed to the defendants. Accordingly, the initial, and dispositive, issue is whether those statements and omissions specified in the complaint as being made

by Time Warner or the individual defendants support plaintiffs' claims.

[1] The quoted statements concerning Time Warner's purported negotiation of strategic alliances all indicate that negotiations were ongoing and that the defendants were enthusiastic about the possible fruits of those negotiations. Plaintiffs do not claim that such negotiations did not occur or that Time Warner conducted them in bad faith; in fact, the complaint confirms Time Warner's negotiating zeal, as it quotes an anonymous European "reportedly involved in one set of negotiations" as saying "Nothing is off-limits to Time Warner." Compl. ¶ 67. None of the attributed statements makes a specific representation as to progress toward completion of the talks or likely partners or any other false affirmative statement. Accordingly, the attributed statements concerning possible strategic alliances alleged in the complaint are not on their face misrepresentations within the meaning of § 10(b).

[2, 3] Plaintiffs contend that Time Warner's statements concerning the existence and promise of negotiations toward strategic alliances raised investor expectations and triggered a duty to reveal that the ballyhooed strategic alliances would not materialize whenever defendants had that knowledge. Plaintiffs are correct that the securities laws require that whatever statements a corporation issues be truthful and complete, and not materially misrepresent the facts existing at the time of the announcement. That duty includes the obligation "to correct prior material statements as they bec[o]me inaccurate." *In re Warner Communications Secur.*, 618 F. Supp. 735, 752 (S.D.N.Y. 1985), *aff'd*, 798 F.2d 35 (2d Cir. 1986). However, despite plaintiffs' unsupported assertion, the duty does not extend to requiring a defendant to reveal various strategic alternatives merely because they revealed one possible approach. Plaintiffs have not identified authority for imposing such a duty, and doing so would place an excessive burden on companies either never to comment on their plans or never to be free to evaluate alternative strategies without exposing all of their deliberations to public scrutiny.

None of defendants' statements quoted in the complaint is inconsistent with plaintiffs' contention that Time Warner in fact was encountering difficulty with its negotiations and may also have been contemplating a stock offering. The defendants' statements simply

expressed their enthusiasm about ongoing negotiations and their belief that strategic alliances, if achieved, would yield improved results and lift the company's stock price dramatically. Both the absence of factual allegations showing that defendants made falsely optimistic predictions and the lack of inconsistency of subsequent events with the statements alleged distinguish this case from *Goldman v. Belden*, 754 F.2d 1059, 1068—69 (2d Cir. 1985) (failure to reveal known negative factors in conjunction with optimistic statements actionable under § 10(b)), upon which plaintiffs rely. Because in the absence of a specific duty to disclose companies are bound to reveal information only if necessary to make other statements the company did not make materially misleading, and because the statements made were not inconsistent with the omitted facts alleged in the complaint, those omissions did not violate a duty of Time Warner under the securities laws.

[4] The complaint's only other relevant quotation of a defendant is from a statement by Gerald Levin, who said in an interview roughly ten months before the class period that the company was worth "a hell of a lot more than $200.00 a share." Compl. ¶ 41. Levin's statement can only be read as his somewhat hyperbolic opinion of the company's inherent worth as of February 1990, and cannot reasonably be understood to hint at his expectation of any future event that would radically alter Time Warner's stock price.

Levin's statement has not adequately been alleged to be either a material misstatement affecting these plaintiffs or any assertion giving rise to a duty to disclose inconsistent facts which may later have become known to the defendants. Because he spoke ten months before the asserted class period, Levin's statement, even if utterly false and fraudulently made, cannot have formed a basis for plaintiffs' expectations when they purchased shares ten or more months later; innumerable intervening factors could have changed the company's value since Levin spoke. Although plaintiffs are correct that a defendant in some circumstances is obliged to reveal facts which become known and which contradict earlier material assertions of fact by a defendant, in the present case any changed circumstances that may have arisen do not contradict Levin's earlier statement, and thus would not trigger a duty to disclose.

Moreover, the complaint fails to allege adequate facts in support of its claim that during the class period the defendant knew or recklessly neglected to realize that the strategic alliance negotiations would fail, and/or that a stock offering would be necessary. Although scienter may be pled generally, the complaint must nevertheless "plead the factual basis which gives rise to a 'strong inference' of fraudulent intent." *O'Brien v. National Property Analysts Partners, 936 F.2d 674 (2d Cir. 1991).*

[5] In this case no "strong inference" of fraud is induced by the facts alleged. Plaintiffs assert three bases for their allegation of scienter. The first is that the anticipated strategic alliance did not materialize and that the company issued stock, events which , according to plaintiffs, by their nature must have been anticipated long before they took place. However, it is firmly established that mere allegations of subsequent events contrary to a defendant's earlier statement or prediction does not establish that defendants knew or were reckless not to know that their statements were false and misleading. *See, e.g., Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (financial results worse than those predicted earlier not adequate basis of fraudulent intent underlying company's earlier predications); *Friedman v. Mohasco Corp.*, 929 F.2d 77, 79 (2d Cir. 1991) (in new stock issue where defendant projected stock price higher than actual price achieved, disappointing results not sufficient basis to allege scienter); *Hershfang v. Citicorp*, 767 F. Supp. 1251, 1257 (S.D.N.Y. 1991) (dividend cut within weeks of public disavowal of that strategy by company officers not sufficient allegation of scienter).

Plaintiffs' second scienter claim, relying on *Beck v. Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987), *cert. denied*, 484 U.S. 1005, 108 S. Ct. 698, 98 L. Ed. 2d 650 (1988), is that defendants had "a strong motive for committing fraud, and an opportunity for doing so," Plaintiffs Br. at 17, a combination deemed sufficient by the Court of Appeals in that case. However, while Time Warner may have had an opportunity to commit fraud, it had no motive for engaging in the scheme alleged here, which could not rationally have been expected to succeed. No matter how vociferously Time Warner claimed that negotiations were going well and no matter how little it said concerning a possible stock offering, it had no unilateral ability, and no

reasonable investor could believe that it did, to cause potential partners to invest in "strategic alliances." And, by plaintiffs' own theory of the case, the company would be compelled to undertake a stock offering if it was unable to attract new partners to invest substantial sums in joint ventures, regardless whether Time Warner convinced the investing public that the company's stock was worth $200 per share.[4/] Accordingly, plaintiffs' "motive and opportunity" scienter allegations are fatally flawed.

The third basis of plaintiffs' scienter claim is the theory that, even if defendants lacked a motive to defraud, they engaged in "conscious behavior" from which an intent to defraud may fairly be inferred. *See Beck*, 820 F.2d at 50 (pleadings of such "conscious behavior" sufficient under Rule 9(b)). However, the court in *Beck* specifically noted that for this theory of scienter to be adequately pled, "the strength of the circumstantial allegations must be correspondingly greater" than allegations of motive and opportunity need be. *Id.* Here plaintiffs' circumstantial allegations consist solely of defendants' references to negotiations that in fact were ongoing and that plaintiffs maintain, without factual support, were doomed to fail at the time of the statements alleged. Aside from Time Warner's failure to conclude those negotiations successfully before it conducted its stock offering, which as discussed above does not support charges of fraudulent scienter, there are no facts alleged whatsoever tending to show conscious fraudulent behavior.

In sum, none of the defendants' own statements quoted in the complaint or their alleged omissions satisfies the pleading requirements of Rule 12(b)(6) for a § 10(b) cause of action, nor have plaintiffs sufficiently alleged defendants' scienter.

[4/] Plaintiffs' theory that the alleged misrepresentations were motivated by the individual defendants' desire to preserve their "creditability" following the creation of Time Warner and their projection of high stock values is not plausible. Defendants' credibility could hardly be enhanced by a scheme to promise new joint ventures knowing that they would not be finalized, all in the face of an allegedly inevitable stock offering.

B. Other Alleged Fraudulent Statements

The remaining allegedly actionable statements are of two types: those quoted in press reports and attributed to unnamed Time Warner sources; and generally alleged but unspecified off-the-record discussions between anonymous Time Warner sources and securities analysts and journalists.

1. Quotations from unnamed Time Warner sources

Time Warner argues both that the complaint's inclusion of anonymous quotations from media reports cannot properly be attributed to it or the individual defendants, and that even if ascribed to them, the statements do not support a securities fraud claim.

There is ample case law establishing that to comply with Rule 9(b) a complaint must "specify the time, place, speaker, and content of the alleged misrepresentations." *Di Vittorio v. Equidyne Extractive Industries, Inc., 822 F.2d 1242, 1247 (2d Cir. 1987); see also Luce v. Edelstein*, 802 F.2d 49, 54 (2d Cir. 1986). Applying this rule in similar circumstances, Judge Mukasey recently held that a "defendant is entitled, under Rule 9(b), to know who made these allegedly fraudulent remarks, when they were made, and where they were made. The complaint's attribution of newspaper reports to a '[defendant's] spokesman' utterly fails to meet this burden." *Hershfang v. Citicorp*, 767 F. Supp. 1251, 1256 (S.D.N.Y. 1991).

[6] Plaintiffs argue that to satisfy the particularity requirements of Rule 9(b) they are not required to allege facts known solely to defendants (which is correct), and that, under *Di Vittorio* and *Luce*, they need only specify that statements were issued by the company collectively. However, those cases do not support plaintiffs' contention. Those cases depended on the fact that the assertions in question were contained in stock offering memoranda, and held that in such cases "no specific connection between fraudulent representations in the Offering Memorandum and particular defendants is necessary where, as here, defendants are insiders or affiliates participating in the offer of the securities in question." *Luce*, 802 F.2d at 55; *Di Vittorio*, 822 F.2d at 1247 (quoting

Luce). The specificity requirements for pleading actionable statements are relaxed in the case of offering memoranda because they are documents of vital importance to any issuing company, and accordingly can be presumed to result from collaborative effort by senior officers of a defendant corporation. The statements in question here, by contrast, were alleged to have been uttered by unnamed spokespersons or even more shadowy figures who are not shown to have been known to defendants, and who, from the pleadings, cannot be said to have been within the defendants' control when they made the alleged statements. The complaint thus fails to present an adequate factual link between the statements and the defendants.

[7] Moreover, the anonymous statements, even if attributed to defendants, are not actionable. The complaint alleges only a few such anonymous statements, including a spokesman's February 15, 1991 assertion that the company had been discussing strategic alliances with many potential international partners and that "Now we are in the process of selecting from among those that share our vision," Compl. ¶ 59; a statement by "Time Warner" that it was still negotiating strategic alliances with a "a significant number of parties," Compl. ¶ 60; and an April 19, 1991 statement by an unidentified spokesman that talks regarding strategic alliances had "intensified." Compl. ¶ 65. In addition, the complaint alleges that in response to rumors of an impending offering the day before it made its announcement, a Time Warner spokesman refused to comment on the possibility of an offering and reiterated the company's pursuit of strategic alliances.

Most of the unattributed statements are as innocuous as those discussed above, merely noting Time Warner's enthusiastic pursuit of its strategic alliance strategy. The mere description of negotiations as having "intensified" does not amount to a claim by Time Warner that success was near, or that an agreement would solve the company's well-known debt burden. And the company's mere refusal to comment on market rumors the day before its stock offering is not actionable because plaintiffs have failed to allege facts tying those rumors to defendants and because "[a] company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company." *State Teachers*

Retirement Board v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981).

It is true that the February 15 statement that Time Warner was "in the process of selecting from among those that share our vision" can be read to imply that Time Warner had received firm offers and would soon announce a strategic alliance of the sort it had described. As discussed above, however, the mere allegation of a prediction of future positive developments (such as the suggestion of likely culmination of negotiations), coupled with a later failure to achieve the promised results, is not actionable. *See Denny v. Barber*, 576 F.2d 465, 470 (2d Cir. 1978); *see also Hershfang v. Citicorp*, 767 F. Supp. 1251, 1257 (S.D.N.Y. 1991).

Plaintiffs' attempt to distinguish this case from the *Denny* line of cases, which concern representations of expected future events, by arguing that the complaint here alleges misrepresentations of facts existing at the time of the statements, namely the status of Time Warner's negotiations toward strategic alliances, which was a fact material to investors at that time. Even accepting this characterization, however, the argument fails.

First, for the same reasons identified in the discussion above of defendants' scienter as to representations chargeable to them, plaintiffs have not adequately alleged defendants' knowledge or reckless neglect of the statement's falseness at the time it was made.

[8] In addition, the statement in question was so oblique that no reasonable investor could rely on it and, as a result, have been injured. No reasonable investor could conclude, based solely on the information that Time Warner had received unspecified offers and was attempting to finalize agreement on at least one of them, that Time Warner would soon obtain a partner to serve as a *deus ex machina* to ease its financial burdens. Because, according to the complaint, Time Warner stock was inflated by the company's false promise of these two results, and because the company's failure to find a sufficiently lucrative strategic partner and its announcement of a new stock offering allegedly precipitated the rapid decline in its stock's value that injured plaintiffs, the possibility of such reliance is a necessary element of the fraud alleged by plaintiffs.

Finally, while plaintiffs may be protected by the usual rule that those facts known solely to defendants need not be pled with

specificity, their position is weakened by their failure to allege any facts, other than the subsequent failure to conclude the negotiations, to support their claim that the comment as to the negotiations' status was false.

Even factoring in the unattributed quotations into the complaint's allegations, then, the complaint still alleges no more than the company's enthusiastic statements about ongoing negotiations and its silence concerning a stock offering, followed by a sudden and surprising announcement of a stock offering with no realization of the hoped-for strategic alliances. These actions do not violate the securities laws.

2. "Off the record" dissemination of false information

The last asserted basis for plaintiffs' allegations of fraud is a collection of reports and recommendations by market analysts and journalists, all of which allegedly drew on background information disseminated by Time Warner in an attempt to shore up its stock price. As with the anonymous statements quoted in various sources and in the complaint, Time Warner argues both that these statements cannot be attributed to the defendants and that, at any rate, they fail to state a claim. Both points are well taken.

[9] First, the allegation of unspecified "disinformation" being spread by unnamed persons supposedly involved with Time Warner utterly fails to "specify the time, place, speaker, and content of the alleged misrepresentations," as is required by Rule 9(b) and *Di Vittorio*, 822 F.2d at 1247. *See also Schwartz v. Novo Industri, A/S*, 658 F. Supp. 795, 799 (S.D.N.Y. 1987) (not "fair" to infer fraud "from a statement appearing in a news article over which defendant had less than complete control").

[10] Moreover, review of the various reports and analyses from which plaintiffs derived their conclusion that Time Warner was planting falsely optimistic disinformation throughout the investment community does not in fact reveal actionable misstatements or omissions by Time Warner or anyone. The reports in question indicate that "serious negotiations" were ongoing and that the company "continue[d] to explore joint ventures . . . which would help Time Warner reduce its debt," Compl. ¶ 44, or that "Management has said that those negotiations involve the potential

sale of minority equity interests in Time Warner assets," Compl. ¶ 49, or that as of February 13, 1991 the company appeared closer to completing such a deal. Compl. ¶ 58. Similarly, various analysts recommended purchasing Time Warner stock because they believed the company would soon accomplish restructuring or alliances that would bring in needed cash and would enhance its business prospects. Compl. ¶ 69. Some of these analyses went on to speculate as to the amount of capital Time Warner's strategic alliances could bring in. Compl. ¶ 67.

As with plaintiffs' other allegations, these reports, even if entirely the result of Time Warner communications with analysts and journalists, merely state that negotiations were ongoing and offered great potential reward for Time Warner and its shareholders. Accordingly, they were neither materially misleading nor inconsistent with the omitted information alleged to have defrauded plaintiffs, and neither worked a fraud directly on plaintiffs nor triggered a duty to disclose the allegedly withheld information. As has been noted, the company's mere failure to achieve the goals it openly had been pursuing and its subsequent adoption of plans harmful to plaintiffs, is not actionable. *See, e.g. Denny, supra*, 576 F.2d at 470; *Hershfang, supra*, 767 F. Supp. at 1257.

V.

In addition to their securities fraud claim, plaintiffs claim that the facts alleged constitute common law fraud and negligent misrepresentation under New York law. Defendants argue that the complaint insufficiently alleges violations of state law and should be dismissed on the merits, or, in the alternative, that the state claims should be dismissed for want of pendent jurisdiction in light of the dismissal of plaintiffs' federal claims.

A. Common Law Fraud

[11] The elements of fraud in New York are "representation of a material fact, falsity of that representation, scienter, reliance, and damages." *Freschi v. Grand Coal Venture*, 767 F.2d 1041, 1050 (2d Cir. 1985), *vacated on other grounds*, 478 U.S. 1015,

106 S. Ct. 3325, 92 L.Ed.2d 731 (1986). Defendants owe plaintiffs no greater duty under New York common law than they do under § 10(b). *See Starkman v. Warner Communications, Inc.*, 671 F. Supp. 297, 308 (S.D.N.Y. 1987). Accordingly, the same defects which affect plaintiffs' § 10(b) claims doom their common law fraud claims.

B. Negligent Misrepresentation

[12] The ordinary rule under New York law is that a cause of action for negligent misrepresentation requires "actual privity of contract between the parties or a relationship so close as to approach that of privity." *Ossining Union Free School Dist. v. Anderson Larocca Anderson*, 541 N.Y.S.2d 335, 338, 73 N.Y.2d 417, 539 N.E.2d 91, 94 (Ct. App. 1989). New York courts have acknowledged that this is a stringent requirement but nevertheless have imposed it "as a means of fixing fair, manageable bounds of liability" in an area of law where "what is objectively foreseeable injury may be vast and unbounded, wholly disproportionate to a defendant's undertaking or wrongdoing." *Id.*, 541 N.Y.S.2d at 337, 539 N.E.2d at 93. Federal courts typically have dismissed negligent misrepresentation claims brought by members of the investing public. *See In re Par Pharmaceutical, Inc. Sec. Litig.*, 733 F. Supp. 668, 686 (S.D.N.Y. 1990).

Plaintiffs argue that their pleadings are sufficient under *Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 493 N.Y.S.2d 435, 483 N.E.2d 110 (1985), which held that privity was not required to state a negligent misrepresentation claim where:

> (1) The [defendants] must have been aware that the financial reports were to be used for a particular purpose or purposes; (2) in the furtherance of which a known party or parties was intended to rely; and (3) there [was] some conduct on the part of the [defendants] linking them to that party or parties, which evinces the [defendants'] understanding of that party or parties' reliance.

Credit Alliance, 65 N.Y.2d at 551, 493 N.Y.S.2d at 443, 483 N.E.2d at 118.

[13] *Credit Alliance* does not save plaintiffs' claim. The non-privity cases that favor plaintiffs all involve dealings among a small

number of parties known to the defendants, and whose reliance on defendant's representations was immediate and obvious. *See Credit Alliance, supra*, 493 N.Y.S.2d at 444–445, 483 N.E.2d at 119–120 (dismissing claim against accountant where existing creditor of corporation relied on financial statement prepared by defendant in extending additional credit but where defendants did not know of a particular purpose for the reports or of contact between defendant and plaintiff; allowing claim against auditor that knew securing financing from plaintiff was primary purpose of audit); *Ossining School district, supra* (allowing claim by district that had contact with architects who in reliance on report of defendant engineering consultant wrongly advised district that facility needed to be vacated). As we read those cases, members of the investing public such as the present plaintiffs enjoy no such close relationship with Time Warner or its officers and were not specifically known to defendants until this suit was filed. Accordingly, the negligent misrepresentation claim is dismissed pursuant to Rule 12(b).

VI.

[14] The sole remaining question as to plaintiffs' dismissed securities and common law fraud claims is whether or not plaintiffs are entitled to replead their allegations. Fed. R. Civ. P. 15(a) provides that "leave [to amend] shall be freely given when justice so requires." Ordinarily, dismissals under Rule 12(b) are with prejudice, but those under Rule 9(b) are without prejudice until plaintiffs have had the opportunity to restate their claims with greater particularity. *See Luce, supra*, 802 F.2d at 56; *see also Ronzani v. Sanofi S.A.*, 899 F.2d 195, 198 (2d Cir. 1990). Indeed, it has been held to be an abuse of discretion for a district court to deny plaintiffs' request to replead more particularly when the complaint is dismissed pursuant to Rule 9(b), even where defendants had once repled their complaint before any responsive pleading was filed. *See Ronzani*, 899 F.2d at 198.

Here, the complaint has been dismissed for numerous overlapping reasons, many of them within the rubric of Rule 12(b)(6), some within that of Rule 9(b). Each statement or omission alleged has been found deficient in at least one respect

under Rule 12(b). Accordingly, there is no doctrinal requirement that the dismissals be without prejudice.

Moreover, here several factors suggest that such leave might not be appropriate even if some small portion of the complaint were dismissed solely pursuant to Rule 9(b). Plaintiffs already have enjoyed a generous opportunity to replead, with their first complaint having been filed nearly a year ago. This is the third complaint plaintiffs have filed, and it therefore appears unlikely that they can do better. Moreover, plaintiffs have enjoyed fairly substantial although not complete discovery, and thus have had a greater than usual opportunity to develop their claims. Finally, the dismissal here goes so overwhelmingly to the merits of plaintiffs' claim, as opposed to the niceties of their pleading, that there would be little to be gained by allowing them to attempt to breathe new life into a complaint based even on any isolated allegations that may have fallen beyond the reach of Rule 12(b).

The fact that dismissals under Rule 9(b) ordinarily are without prejudice is in large part due to the desirability of allowing plaintiffs full opportunity to express potentially valid claims. If a case is dismissed for errors of wording, the policy favoring liberal pleading requirements dictates that plaintiffs receive at least one chance to state their claims more appropriately. However, because Rule 9(b) governs all allegations of fraud and of scienter, dismissals under the Rule may also occur for deficiencies more substantive than formal. In such cases the compelling reasons for allowing repleading carry less force; plaintiffs may well have pled all facts and circumstantial indications of fraud they can muster and still fall short of the mark, because the circumstances by which they claim to have been aggrieved simply do not allow an inference of fraud. This is one such case. When plaintiffs appear to have alleged all they are able, and where, as here, they have repleaded not once but twice, the ordinary presumption of plaintiffs' entitlement to replead following dismissal pursuant to Rule 9(b) is vitiated.

* * * * * *

The complaint is dismissed.

It is so ordered.

1. SEC Rule 10b–5, 17 C.F.R. § 240.10b–5

§ 240.10b–5 Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

(Sec. 10; 48 Stat. 891; 15 U.S.C. § 78j)

[13 FR 9193. Dec. 22, 1948, as amended at 16 FR 7928, Aug. 11, 1951]

2. SEC Rule 175, 17 C.F.R. § 230.175 (1993)

§ 230.175 Liability for certain statements by issuers.

(a) A statement within the coverage of paragraph (b) . . . which is made by or on behalf of an issuer . . . shall be deemed not to be a fraudulent statement (as defined in paragraph (d) of this section), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

(b) This rule applies to the following statements:

(1) A forward-looking statement (as defined in paragraph (c) of this section) made in a document filed with the Commission. . . .

(c) For the purpose of this rule, the term *forward-looking statement* shall mean and shall be limited to:

(1) A statement containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;

(2) A statement of management's plans and objectives for future operations;

(3) A statement of future economic performance contained in management's discussion and analysis of financial condition and results of operations included pursuant to Item 303 of Regulation S-K (§ 229.303 of this chapter) or Item 9 of Form 20-F; or

(4) Disclosed statements of the assumptions underlying or relating to any of the statements described in paragraphs (c) (1), (2), or (3) of this section.

3. 48 Federal Register 52,889 (1983) [regarding SEC Shelf Registration Rule (Rule 415)]

IV. Discussion

. . .

B. Concerns

1. Adequacy of Disclosure

. . .

For Securities Act registration, the integrated disclosure system builds upon the existence of timely and accurate corporate reporting. Thus, registrants that are widely followed in the marketplace may use Forms S-3 and F-3, which allow maximum use of incorporation by reference of Exchange Act reports and generally do not require information contained in those reports to be reiterated in the prospectus and delivered to investors. Forms S-3 and F-3 recognize the applicability of the efficient market theory to those companies which provide a steady stream of high quality corporate information to the marketplace and whose corporate information is broadly disseminated. Information about these companies is constantly digested and synthesized by financial analysts, who act as essential conduits in the continuous flow of information to investors, and is broadly disseminated on a timely basis by the financial press and other participants in the marketplace. (Footnote omitted) Accordingly, at the time S-3/F-3 registrants determine to make an offering of securities, a large amount of information already has been disseminated to and digested by the marketplace.

. . .

4. 46 Federal Register 41,902 (1981).

Reproposal of Comprehensive Revision to Systems for Registration of Securities Offerings

II. Overview

Under the proposed registration statement framework, registrants would be classified into three categories:

. . .

The first category would be eligible to use proposed Form S-3, which relies on incorporation by reference of Exchange Act reports and contains minimal disclosure in the prospectus. This form is predicated on the Commission's belief that the market operates efficiently for these companies, *i.e.*, that the disclosure in Exchange Act reports and other communications by the registrant, such as press releases, has already been disseminated and accounted for by the market place.

. . .

Proposed Form S-3 recognizes the applicability of the efficient market theory to the registration statement framework with respect to those registrants which usually provide high quality corporate reports, including Exchange Act reports, and whose corporate information is broadly disseminated, because such companies are widely followed by professional analysts and investors in the market place. Because these registrants are widely followed, the disclosure set forth in the prospectus may appropriately be limited, without the loss of investor protection, to information concerning the offering and material facts which have not been disclosed previously. The abbreviated disclosure is made possible by the use of incorporation by reference of the registrant's Exchange Act information into the prospectus. Because of the abbreviated disclosure, the utility of proposed Form S-3 is limited to widely followed companies.

5. American Stock Exchange Company Guide § 402(f) at pp. 4–10 (Supp. 1988).

How soon after the release of material information insiders can begin to trade . . .

[d]epends both on how thoroughly and how quickly after its release the information is published by the news-wire services and the press. In addition, following dissemination of the information, insiders should refrain from trading until the public has had an opportunity to evaluate it thoroughly. Where the effect of the information on investment decisions is readily understandable, as in the case of earnings, the required waiting period will be shorter than where the information must be interpreted before its bearing on investment decisions can be evaluated. While the waiting period is dependent on the circumstances, the Exchange recommends that, as a basic policy, when dissemination is made in accordance with Exchange policy . . ., insiders should wait for at least 24 hours after the general publication of the release in a national medium. Where publication is not so widespread, a minimum waiting period of 48 hours is recommended. Where publication does not occur, or if it should otherwise appear appropriate, it may be desirable to obtain an opinion of counsel before insiders begin to trade.

Portions of the Consolidated Amended Class Action Complaint

8. At all relevant times, Time Warner common stock traded in an open, well-developed and efficient market and the trading price of its stock adjusted to reflect publicly available information regarding the Company and its present and future prospects. . . .

28. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

. . .

(e) whether defendants' misrepresentations and omissions constituted a "fraud on the market" in Time Warner's common stock during the Class Period; . . .

90. Throughout the Class Period, the market for trading in Time Warner common stock was open, well-developed and efficient and assimilated the materially false and misleading information disseminated by defendants. The market price of Time Warner common stock reacted promptly to disclosure of material information which was not previously disclosed or anticipated. . . .